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on Impact of international trade and the EU's trade policies on global value chains

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Global Value Chains (GVC) - definition and general background

GVCs have become a key feature of today's global economy and are at the heart of international trade and investment policy. International production is substantially structured around GVC and coordinated by multinational companies through networks of affiliates, contractual partners or arm's length suppliers. This fragmentation of production across borders offers new prospects for growth, development and jobs. Yet, the complex nature of GVC and its subsequent low level of transparency has led to a higher risk of human rights violations and disrespect of social, fiscal and environmental regulations. Today free trade has come under increasing public scrutiny. Concerns about trade benefitting only a few have brought to the forefront a largely shared view that trade policy needs to put social and environmental values as well as transparency and responsibility at its core. Against this backdrop, trade must be seen not only as a facilitator for GVC but also as a tool to set clear rules for GVC to comply with these values, namely through the 2030 sustainable development goals (SDG).

In this vein, the EU's trade strategy "Trade for all" bases EU trade policy on three key principles: effectiveness, transparency and values, and has a dedicated sections on responding to the rise of GVCs and using the trade agenda to promote sustainable development, human rights and good governance. In addition, policy coherence requires that EU trade policy does not undermine efforts to achieve the 2030 SDG

The EU has a key role to play in lifting the standards of transparency, responsibility and sustainability of GVC. The EU has launched country-specific partnerships such as the Bangladesh Sustainability Compact and the Myanmar Labour rights' initiative. FLEGT and Conflict Minerals Regulations are among the first sector specific binding steps taken at the EU level. Yet, in the absence of a comprehensive EU initiative, several Member States have adopted national laws such as the French law on duty of care for multinational companies[1] and the UK Modern Slavery Act[2].

These initiatives articulate with several international non-binding guidelines for states and businesses aimed at increasing transparency and prevent human rights abuses such as the UN guiding principles on Business and Human Rights, the UN Global Compact, OECD Guidelines for Multinational Enterprises, several sector-specific OECD guidelines (financial sector, agriculture, minerals, garment and footwear) and ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy. The ILO Agenda for decent work is also recognised as an integral part of the 2030 sustainable development Agenda.

This working document seeks to set recommendations on the role of international trade and investment policy frameworks in shaping GVCs to become transparent and sustainable, while ensuring that the EU keeps its position in higher value added segments of the GVCs.

GVCs involve a wide range of actors and institutions and span a broad number of trade and investments regimes. Although not a new feature of the global economy, they play an increasingly imporant role as over 50% of trade in goods take place in intermediaries, many of which constitute intra-industry trade within large multinational corporations (MNCs). This

[1] http://www.assemblee-nationale.fr/14/ta/ta0924.asp
[2] https://www.gov.uk/government/collections/modern-slavery-bill

increase can be explained by four key factors: 1) the development of telecommunications, financial services and information technologies which have enabled a real time coordination and logistics of fragmented production; 2) improvements in infrastructure, logistics and transport services; 3) reduced cost of trade through trade and investment liberalisation; 4) the emergence of China and India that doubled the supply of labour at low cost in global economy.

GVCs are not evenly spread across the world. Since countries participating in GVC have very different levels of developent, social and environmental dumping feature among the challenges to be addressed. Most developing countries are in periphery of the main GVCs networks and have therefore difficulties in entering and / or capturing the value in GVCs. Similarly GVCs are not uniform and can have different developmental impacts - some are created by research-driven companies, some by market-driven companies looking to source in low-cost locations or by resource-seeking investment focusing on extractive industries.

GVCs are largely driven by investment decisions of MNCs- around 80% of global trade is linked to MNCs´ international production networks. Yet, over the past 30 years, the substantial increase on corporate profitability has largely been driven by the financialisation of corporate strategies, focused on short term decision making, cost management and financial engineering. This has to some extent resulted in the increase of delocalisation of companies to the countries with weaker regulations and lower labour costs and also in tax evasion and avoidance practices.

EU trade policy can be a tool to address these challenges in promoting higher social and environmental standards and strengthening cooperation to fight against, corruption, corporate profit shifting and tax avoidance strategies that make use of the fragmentation of value chains.

Participation in GVCs presents opportunities to developing countries and its firms to build productive capacity, integrate to world market and upgrade its services and manufacturing sectors. Empirical analysis by UNCTAD shows a strong correlation between the degree of participation in GVCs and economic growth. However, such potential benefits are not automatic as participating in GVCs may also increase the vulnerability to external shocks. A complementary policy agenda is needed for the creation of more decent jobs, an increased participation of women in the labour force, and a transfer of skills and technology, in particular with the aim of transiting towards a low carbon economy.

GVC Governance

One of the main challenges of GVCs, is the broad array of factors that they encompass (trade, services, investment, skills, technology and data flows). The increasing complexity and transnational scope of supply chains explains the difficulties in the governance of GVCs. Governance can typically be approached at three different levels; firm level, nation state level and international trade system level.

Firm level: The objective of the firm in governing GVCs is to create the most cost-efficient production. The leading firm usually sets and enforces the parameters under which other firms in the network operate and typically drives governance through investment, outsourcing and offshoring activities. One of the main challenges at firm level include the way in which benefits are divided between MNC and SME partners in different locations and how to ensure that investment, outsourcing and offshoring activities comply with the SDG and with international efforts on financial transparency and anti-tax evasion and avoidance policies.

Nation state level: Governance of GVCs at state level requires finding a balance between developing sustainable industrial strategies that protect and promote decent jobs and the environment while at the same time creating an enabling environment for firms to engage in GVC operations and position their country in the higher segments of value added. An increasingly liberalised trade agenda therefore has to be in line with sustainable development related policies.

International trade system level: GVC governance at international trade system level looks at decisions that affect trade and investment flows between several trading partners and the international trading system as a whole.

GVCs - opportunities and challenges

Tariffs: In a world of fragmented production networks the distinction between exports and imports is blurred as the imported inputs account for a significant proportion of exports. Therefore, tariffs on inputs into the supply chain may result in negative protection to downstream companies and they cumulate each time that intermediate inputs are traded across borders.

Rules of Origin: new trade patterns also merit revisiting the rules of origin to analyse whether they are still best fit for its purpose.

Services represent nearly half of the world's trade in value-added terms and over 75% of EU jobs are in the services sector. Therefore it is key to regulate this sector in trade agreements so as to promote EU values and standards and to ensure that the EU remains a forefront high value added service provider in the world.

Trade facilitation: efficient customs and border procedures are especially important in the context of GVCs as intermediaries cross border several times. In this context, the fast implementation of WTO Trade Facilitaion by as many countries as possible, is essential.

Gender: Women are inclreasingly employed in GVC but this global trend has not been accompanied by a decrease in gender inequality. Women are still overrepresented in low wage and low skill tasks. Trade-related policies should mainstream gender aspects and be based on gendered GVCs analysis.

Transparency and due diligence: binding due diligence initiatives moving beyond traditional voluntary corporate social responsibility are increasingly seen as an appropriate tool to ensure responsible supply chains. Furthermore, more ambitious labelling measures along the whole supply chain are needed in order to improve consumers' access to information about the social and environmental conditions under which « made in world » goods are produced.

Trade preferences: **GSP+** can be used as a tool for promoting responsible GVCs;

Social and environmental standards: these may be seen by developing countries as protectionist measures. Development asymmetry must therefore be taken into account and appropriate accompanying measures taken.

Recommendations

In the current context of mounting nationalist populisms and protectionism, the EU should take the opportunity to frame the debate on the governance of GVC and focus on policy instruments and practices that put European values and standards at its heart. Recommendations for this include;

- **Inclusion of binding and enforceable sustainable development chapters** in all trade agreements with sanctions for non-compliance with labour or environmental standards. These should be based on existing international consensus on combatting climate change and protecting labour rights and be accompanied by appropriate burden-sharing towards developing countries including through special and differential treatment measures.

- More prominence to specific provisions committing the parties to promote **corporate social responsibility** and the uptake of relevant OECD and ILO guidelines in FTAs;

- Compliance of such chapters and agreements should be conducted by **independent monitoring bodies** (with the involvement of civil society, including private sector) rather than the EU alone;

- Development of **standstill clauses** for fixing a minimum level for social, environmental and safety standards in all EU trade agreements;

- Establishment of cooperation mechanisms in trade and investment agreements aiming at **combatting illicit financial flows** namely tax evasion and avoidance practices by MNCs through transfer pricing and profit shifting facilitated by offshore financial centres. These mechanisms should include transparency measures such as country-by-country reporting of MNCs, automatic information exchange of MNCs fiscal information and the establishment of a public register of beneficial ownership;

- **Establishing WTO compatible border adjustments** measures under the general exception clause of the GATT art XX and GATS art XIV in order to preserve and promote European values and social and environmental standards

- **Extension of jurisdictional rules under Brussels I regulation**[1] to third countries in actions against parent companies domiciled or having substantial business or their main place of business outside of EU;

- Transparency and responsibility of GVCs- request Commission to develop further legislative proposals **for corporate social responsibility** to be enshrined in European

[1] Regulation (EU) No 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (OJ L 351, 20.12.2012, p. 1)

law in a binding form, **in light of national legislations such as the new French bill on the duty of care of multinational companies;**

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