

Global Agenda Councils on Competitiveness and Trade and FDI

# The Case for Trade and Competitiveness

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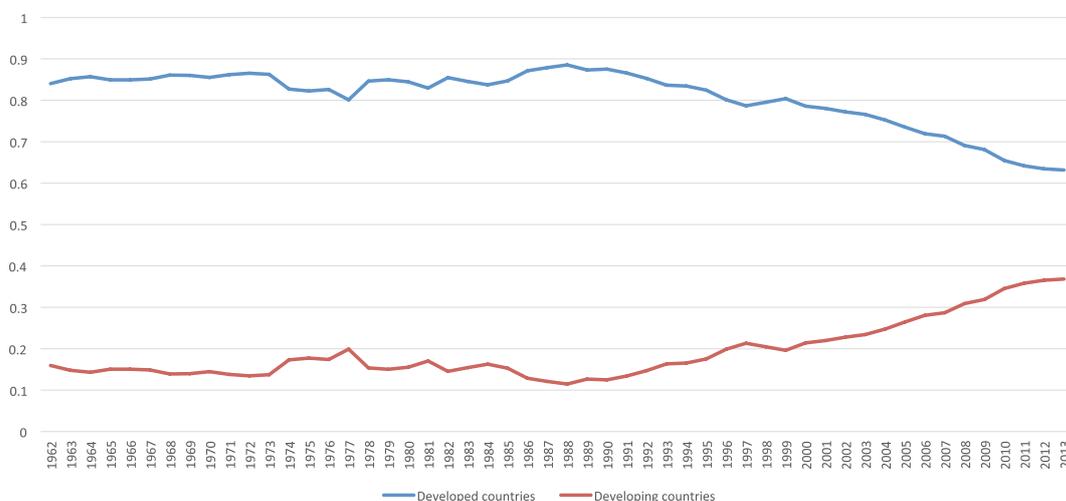
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# Introduction

Openness to trade, investment and even the movement of people is vital for prosperity, peace and individual freedom. And there have been few better moments in history to reconfirm the role of trade as central to global growth, job creation and development. Today's economic circumstances are full of challenges. Global growth remains fragile after the 2008-2009 crisis, with few bright spots in the global economy. Potential output growth has declined in recent years across developed and developing economies owing to structural factors that led to lower productivity growth (IMF, 2015). Trade growth is weaker than at any time in the past two decades. In some quarters there is a sense that the financial crisis presents a case to roll back much of the deep integration that began after the Second World War and took hold rapidly since the 1980s. Global opinion shows views on openness are uneven. A September 2014 Pew poll indicated that while there is strong support for trade in developing countries, the picture is more mixed in advanced economies, particularly in perceptions of employment and wage effects (Pew Research Center, 2014). Yet it is these advanced economies that have historically been the drivers of a more globally integrated world, leading eventually to a multipolar world with changing global political-economic relations.

At the same time, there are signs of new energy in global integration. Negotiations have intensified in several major groupings, including the Trans Pacific Partnership, the Transatlantic Trade and Investment Partnership between the European Union and the United States, the Regional Comprehensive Economic Partnership (RCEP) in Asia, the Pacific Alliance in Latin America and the Tripartite Free Trade Agreement in Africa. Since the December 2013 Bali Ministerial Conference, the World Trade Organization (WTO) has a new agreement on trade facilitation. When viewed within a longer perspective, this energy is not surprising, forming part of a long trend towards more closely interlinked global markets. With the move to a more multipolar global economy, more players have joined the game. Since 1970, the share of developing countries in global trade flows has more than doubled, now making up close to 40% of world trade. An almost fourfold increase has brought them to half of the share in global foreign direct investment flows; and their share in global GDP has doubled from 15% to 30%.

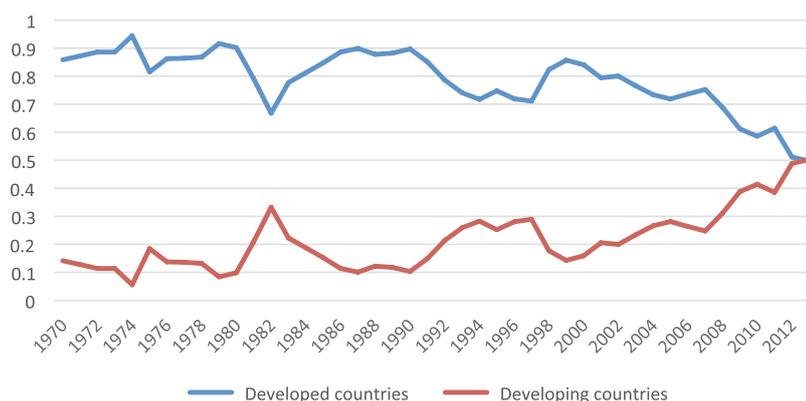
**Figure 1:** Share of trade over world trade by country group



Source: Calculations based on COMTRADE

Note: Trade includes imports and exports

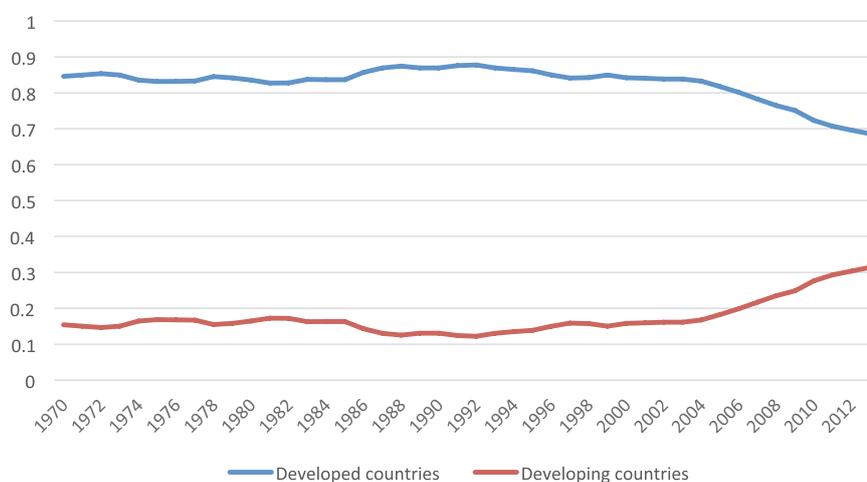
**Figure 2: Share of total flow of FDI over world FDI by country group**



Source: Calculations based on UNCTAD FDI dataset

Note: Total FDI includes inward and outward FDI. Developing countries include developing and transition economies

**Figure 3: Share of GDP over world GDP by country group**



Source: World Bank WDI

Note: GDP is in US\$

These developments have also intensified competition in global markets, which, in turn, implies a greater need to be competitive to generate additional market opportunities and economic links in the presence of many more participants vying for the same space. The increasing spread of global value chains (GVCs) and skills present opportunities for countries to connect to high value-added parts of production processes without having to develop entire industries within their borders. GVCs have also brought into sharper focus the importance of trade facilitation, investment and “behind-the-border” policies for competitiveness.

Finally, since the global financial crisis, policy-makers have focused mainly on macroeconomic policies, emphasizing fiscal and monetary stimulus as well as financial reregulation. This is not the place to argue the pros and cons of such policies. However, such a focus has come at the expense of attention to structural reforms to address sluggish productivity within economies. Microeconomic constraints to growth – distortions in product and factor markets, education, skills, infrastructure – have not been sufficiently addressed.

This is where the competitiveness agenda kicks in. Trade and competitiveness are intimately connected. Competitiveness can be defined as the set of factors – policies, institutions, strategies and processes – that determine the level of sustainable productivity of an economy, be it the world, a continent (or macro region), nation, region or even a city (World Economic Forum, Global Competitiveness Report, 2014). Competitiveness centres on productivity – the efficiency with which an economy uses available inputs to produce outputs. It determines the rate of return on investments, which fundamentally drives economic growth. Openness to the world – through trade, investment and the movement of people – is crucial to competitiveness. But openness on its own has its limits. To reap its benefits fully, it must be combined with productivity-enhancing reforms at home. This is the rationale for pursuing reforms to advance a twin focus on trade and competitiveness.

Against this backdrop, what can openness to trade and investment contribute to a sustained global recovery? How can the potential gains through global value chains be harnessed? How do countries increase their competitiveness to take better advantage of the global economy?

# I. On the link between trade and competitiveness

## Why openness still matters

The historical record is clear: no country has developed successfully in modern times without harnessing economic openness for its national development. Of course, the paths taken by individual countries have varied greatly. Of the 13 countries with sustained growth trajectories surveyed in the landmark 2009 Growth Commission report, each took different pathways and had different mixes of economic activities (Commission on Growth Report, 2008). However, the common thread between the countries that have grown successfully is that they have exploited the potential offered by openness to create new economic opportunities for their people. They have also harnessed global economic forces to drive greater efficiency, innovation and productivity in their own economies. In other words, they have not only looked within for the elements needed to bring long-term prosperity but also have looked outside their borders and made the most of what economic integration can offer.

Although openness comes with risks and costs, experience shows that when managed effectively these are short-term and far outweighed by the long-term gains. The benefits of trade and investment integration can be thought of in two ways, both of which are well known. First, they help create new economic opportunities by increasing the size of the market available to domestic firms as well as driving potential value chains with which they could link up their own production. Second, they drive productivity and innovation by exposing firms to international competition, expertise and technology.

Through these two channels, trade makes a significant contribution to poverty reduction, helping to unleash the potential of the private sector to create jobs. It is wages earned through jobs that provide the key means for improving welfare: countries such as China and Vietnam, following in the footsteps of previous generations of East Asian Tigers, have been able to lift hundreds of millions out of poverty through steady growth in the wages earned by workers in fast-growing economies (World Bank Group and WTO, 2015). And in advanced economies, employment and wage levels have become a key test of the effectiveness of economic growth in delivering widespread benefits.

Along with its economic benefits, openness to the global economy brings geopolitical benefits. Although the world is going through a turbulent phase geopolitically – from the Middle East, to Ukraine, to maritime East Asia – there is no doubt that the close ties brought about through ever-deeper economic integration have contributed greatly to

overall peace and stability since the Second World War. At the regional level, growing understanding of how integration among neighbours can deliver long-term economic gains has led to increasingly close cooperation. In East Asia, for example, although tensions occasionally surface, economic dependence through regional production networks, uniting the ASEAN countries with northeast Asia (China, Hong Kong, Japan, Taiwan and the Republic of Korea) makes all-out conflict today highly costly and much less likely.

At a personal level, openness has helped increase individual choice and freedom. Insular societies of past generations have become progressively more open and outward-looking, thanks partly to increasingly open flows of trade and investment – and with them ideas, expertise and people. The benefits of openness for consumers are too often overlooked, with attention often falling on the more concentrated gains or losses felt by producers in specific sectors. Citizens in economies that have become more open are presented with greater choice in products and services. In short, openness has expanded the freedom to produce and consume in daily life, thereby widening the life choices and prospects for large numbers of ordinary people.

## Beyond openness – the need for competitiveness

Openness is an indispensable enabler of growth, job creation and development. But openness alone does not lead to success. The competitiveness of economies in an integrated world determines how well they convert the potential created by access to global markets into opportunities for their firms, farms and people. What does this entail?

First up are policies and regulations that affect the business climate. Stable macroeconomic conditions are critical, as are well-functioning markets for the key inputs in any economy – land, capital and labour. The level of competition in the domestic economy is an important determinant of how well its firms will compete with the rest of the world. Innovation capacities can give a competitive edge to firms; as can the capacity to bring small and medium sized enterprises (SMEs) from their formative stages to businesses with the ability to compete in a global market.

“Institutions” are as important as “policies”. These include efficient public administration, timely decision-making and the rule of law – all aspects of “good governance”. Also important is “hard” infrastructure – transport (airports,

ports, roads and railways), communications, energy and logistics, along with “soft” infrastructure, including education and skills. Finally, an understanding of how policies and institutions interact to affect competitiveness, both at the level of the economy overall and at the level of particular industries, is important.

Competitiveness is often presented as a relative concept (i.e. an economy is more competitive than another one), which leads many to see competitiveness policy as a zero-sum game. In reality, improving competitiveness simply means to create conditions that allow an economy to allocate scarce resources where opportunities arise as external and internal conditions change. At the global and continental (or macro-regional) level, uncooperative national policies are a primary constraint to competitiveness. And as production increasingly transcends borders, the spillover effects of domestic policies multiply in number and size. Improving competitiveness is as much a collective effort as an individual one. Countries that want to boost the productivity of their economies need to cooperate to have functioning and up-to-date supranational institutions and frameworks.

Indeed, the content of most economic integration agreements today is a striking demonstration of the wide range of policies that shape a country’s interaction with the global economy. “Trade agreements” stopped being only about tariffs and market access rules years ago. The mega-regional deals currently under negotiation will cover economic activities and areas of regulation that were once thought well beyond the purview of international negotiations. These include rules on investment, services, intellectual property, public procurement, state-owned enterprises, coherence of domestic regulations, competition policy transparency, SMEs, environmental regulation and labour standards.

It is striking that attention on these competitiveness policies is focused not only at the national and international level. With cities contributing 80% of the world’s GDP – despite housing just over a half of the world’s population – a growing focus on the drivers of competitiveness at the city and sub-national level is unsurprising. Attracting international trade, investment and mobile talent, as well as finding productive niches in GVCs, are now critical to city and sub-national competitiveness. Engagement between governments at the city and sub-national level, the private sector and other stakeholders can reshape the environment in which business operates and significantly boost prosperity.

### **Box 1 – The role of subnational governments in trade and investment**

In our globalized world, trade will increasingly be dealt with in all levels of government, from supranational to local. Presently, virtually all large subnational governments conduct foreign economic relations, centred on the need to promote trade and attract foreign direct investment (FDI). To this end, they have adopted a myriad of tools, strategies and policies, including:

- Trade and investment agencies to offer one-stop consultancy services
- Trade and FDI offices abroad
- Legal mandates on trade promotion
- Clear external strategies as a means of presenting policy preferences and priorities (e.g. “visions”, “guidelines” or “white books”)
- Trade missions
- Participation in international fora and negotiations
- Rankings and best practices

Source: Rodrigo Tavares



# II. Strengthening competitiveness for trade: the what, the how and the role of connectivity

## The competitiveness taxonomy

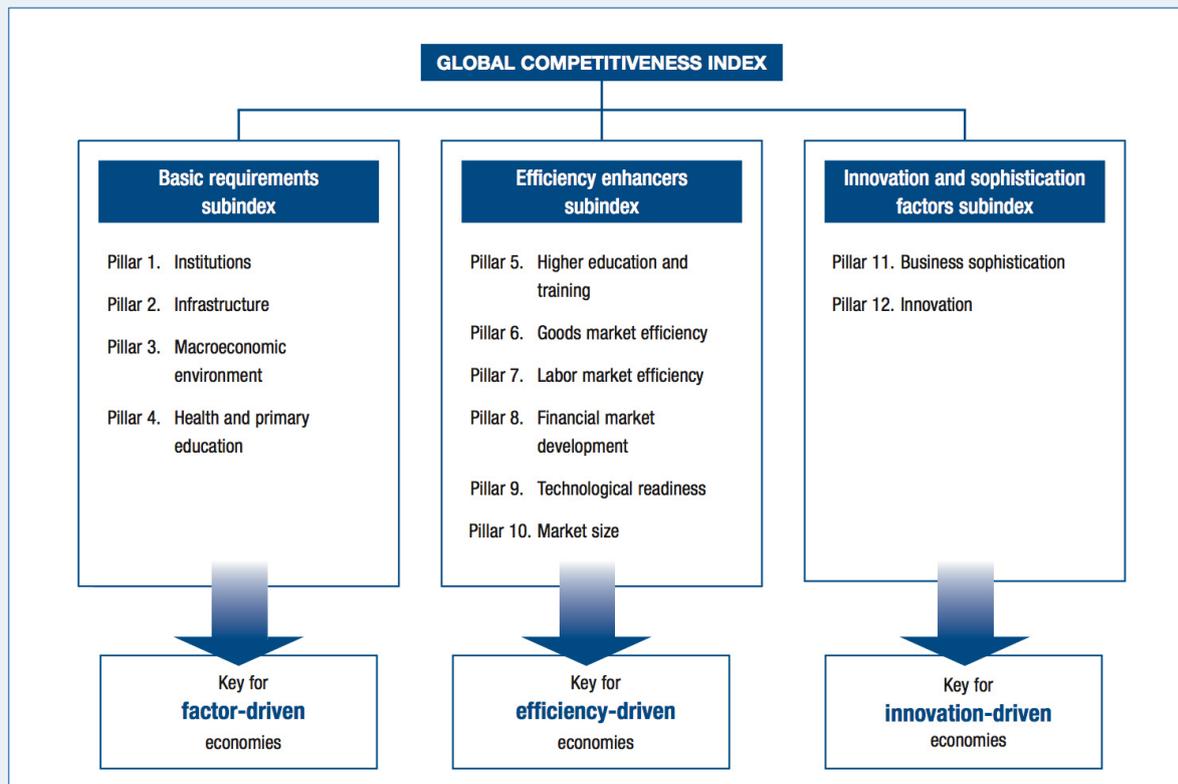
To maximize the gains from trade and reap the benefits of GVCs, openness needs to be combined with competitiveness at home. But what does this mean exactly? Priorities in each country, city or region will differ, based on different endowments, starting points

and levels of development. The four-part taxonomy of the World Economic Forum's Global Agenda Council on Competitiveness report, *The Competitiveness of Cities*, provides, however, a relevant framework for action. This framework is at the same time complementary to the World Economic Forum's Global Competitiveness Index.

### Box 2 – The competitiveness taxonomy and the Global Competitiveness Index

The competitiveness taxonomy presented in the main text provides a framework for action for countries that wish to improve their competitiveness. It focuses on many of the softer aspects of competitiveness and is complementary to the World Economic Forum's Global Competitiveness Index (GCI), which benchmarks many of these concepts. The GCI provides policy-makers with a set of quantitative indicators that enable them to assess their countries' performance in the different policy areas. The GCI measures the factors, policies and institutions that determine the productivity of a country. It includes 12 pillars of competitiveness that are organized in three sub-indexes (see Figure 1 below). A special feature of the GCI is that it integrates a country's stage of development into the measurement.

Figure 1: The structure of the Global Competitiveness Index



Source: World Economic Forum 2014

Conceptually, the two approaches overlap and the GCI can be used to quantify performance on key areas of

the taxonomy. One approximate mapping of the two approaches is shown in Table 1 below.

**Table 1:** Mapping of elements of the taxonomy of competitiveness and Global Competitiveness Index

Taxonomy of drivers of competitiveness	Corresponding GCI pillars of competitiveness
<b>The “What” of Competitiveness: Policies, Regulations, Priorities</b>	Macroeconomic Environment (Pillar 3), Goods Markets Efficiency (Pillar 6), Labour Markets Efficiency (Pillar 7), Financial Markets Development (Pillar 8), Market Size (Pillar 10)
<b>The “How” of Competitiveness: Institutions</b>	Institutions (Pillar 1)
<b>Hard Connectivity</b>	Infrastructure (Pillar 2)
<b>Soft Connectivity</b>	Health and Primary Education (Pillar 4), Higher Education and Training (Pillar 5), Technological Readiness (Pillar 9), Business Sophistication (Pillar 11), Innovation (Pillar 12)

Source: Margareta Drzeniek

The four parts of our taxonomy are: 1) policies and regulation; 2) institutions; 3) hard connectivity; and 4) soft connectivity.

### 1. The “What” of Competitiveness: Policies, Regulations, Priorities

This is the framework of public policies and regulation that shapes competitiveness. It indicates “what to reform”, key policy reforms already done, and those that are needed for “unfinished business”. The main factors are:

- **Stable macroeconomic conditions** – a function of fiscal, monetary, financial and exchange-rate policies.
- **Business-environment policies and regulations** that relate to markets for goods, services, capital and labour, many of which are well captured in the World Bank Doing Business Index.
- **Foreign economic policies** that position the country, region or city in the global economy through international trade, finance, foreign direct investment, foreign workers and tourism as part of clusters of economic activity linked to GVCs.

A framework for competitiveness includes making clear priorities. The challenge is to figure out the “what” of competitiveness and to implement a coherent set of policies. Competitive economies do a number of things well. They have stable macroeconomic conditions. Their business climate keeps transaction costs low, encouraging savings and investment and enabling vigorous competition. They have a modern, well-regulated financial sector that turns savings into productive investments. They invest in both hard and soft infrastructure. They encourage the acquisition

of technology from abroad as well as entrepreneurship and innovation at home. And they are characterized by clusters of economic activity – in manufacturing, services, agriculture and natural resources – that are plugged into GVCs.

Much of the above entails “getting the basics right”. This is perhaps the primary lesson for good public policy. Getting the basics right is fundamentally about simplicity. Really good policy is about keeping it simple for producers, consumers and citizens. Simplicity is also the best form of transparency and predictability. Often complex policies – all sorts of specific measures on this and that, tax breaks here and subsidies there, discriminating in favour of company A at the expense of company B – are a recipe for bureaucratic overreach, incompetence, corruption, low productivity and low growth. At the city level, Singapore, Hong Kong, Dubai, Chattanooga, Pittsburgh, Ahmedabad, Hyderabad and Ningbo present interesting examples of getting the basics right, which have helped them attract FDI and plug into GVCs.

### 2. The “How” of Competitiveness: Institutions

This is the governance or decision-making framework for competitiveness. It is about how key decisions get made and how key reforms come about. As one studies economic history, it becomes clear that policy priorities (“what to reform”) may be the easier part of the challenge. Many of these are well known. It is more difficult to understand why some countries (and regions and cities) manage to implement initiatives that set their economic life on a new trajectory while others struggle to do so. It is easy to ascribe this difference to “leadership”, which is always important but often difficult to emulate. Leadership is part of the equation, but understanding how institutions emerge, how social capital is built and how cooperation is fostered provides a much more nuanced challenge to those wishing to understand how to drive change.

The following are factors of “how to reform” that we highlight:

- The political and legal systems of government
- Relations among national, state/provincial and municipal levels of government
- Relations with organized interests (business, trade unions and non-governmental organizations)
- Public-private collaboration
- Individuals and leadership
- Role of ideas (“vision”) and the national, regional or city brand
- Timing of major reforms, including taking advantage of crises and critical turning points

Trade agreements can contribute to national (and subnational) institutional strength by locking in sensible policies, including openness to trade and investment, and preventing their rollback. That is part of the WTO’s *raison d’être*. The Uruguay Round commitments and China’s accession to the WTO are cases in point. For this reason, over 20 years ago Mexico put a priority on the North America Free Trade Agreement (NAFTA), not only to gain access to US markets but also to safeguard and extend Mexico’s trade and other economic reforms. In contrast, institutions that have been weakened continually by political fiat have often been associated with high protectionist barriers and weak (or non-existent) commitments in trade agreements.

Strong institutions – among them clean and efficient government and public services, the rule of law, impartial enforcement of property rights and contracts – are a major part of competitiveness. Preferably, there should be a strong focus on institution-building at the outset, though, in some circumstances, countries, regions and cities can enjoy catch-up growth for a while even with weak institutions. But there comes a point when robust institutions matter much more to safeguard and sustain progress, usually at middle-income levels of development. And they are critical for specializing in higher-value niches in GVCs.

### **3. Hard Connectivity**

“Infrastructure” has been a key factor in city competitiveness from ancient times through the Middle Ages to modernity and the present. Today we speak in broader terms of “connectivity”. But connectivity has two components: hard and soft. Hard connectivity is the core physical infrastructure that connects people to energy, water and other services. The main elements we highlight are transport (air, road and rail), communications, energy and logistical systems (especially those that feed into regional production clusters and GVCs). Hard connectivity seems to have been especially important during the industrial age. Examples abound of countries, cities and regions that capitalized on their rivers, canals, lakes, maritime ports, railroads, roads and airports – not least to attract foreign investment and expand international trade.

Rich and poor countries have hard connectivity gaps. The biggest gaps are in poor countries, and particularly in their cities. McKinsey Global Institute estimates that infrastructure spending will have to increase to \$20 trillion annually by 2025 to cope with urbanization trends. Without this ramping up of infrastructure, cities, and their wider regions and nations, will hit barriers to sustainable growth and be stuck with sprawl, congestion, pollution and inadequate public services. And they will not take full advantage of international trade opportunities. This is true of cities across Asia, the Middle East, Africa and Latin America.

### **4. Soft Connectivity**

Soft connectivity encompasses all the global linkages that are not physical in nature. It is the “social capital” and “knowledge capital” that make investments in hard infrastructure and new technology (such as broadband access) more productive, something now seen as being as important as hard connectivity. In fact, they are mutually reinforcing. It is about innovation in the broad sense – not just technological innovation. And it concerns an atmosphere of tolerance, free expression and cosmopolitanism. These are characteristics of what the philosopher Sir Karl Popper calls the “open society”. They are highly conducive to the generation and dissemination of ideas, entrepreneurship, innovation and economic growth – just as they were in medieval European cities and in pre-colonial port-polities in the Indian Ocean and South East Asian archipelago.

We highlight the following soft connectivity factors:

- Technological innovation and diffusion (in government, in business and through public-private linkages)
- Education and training systems
- Innovative ecosystems involving small and medium-sized enterprises
- Entrepreneurial culture
- Hubs for intellectual property, including data storage
- “Liveability” – quality of life factors – to attract and retain talent
- Relationships that foster trust and affinity leading to commercial and financial interactions (such as Chinese and Indian diaspora trade networks)
- An “open society”

Education is at the heart of soft connectivity. It is no coincidence that Boston, which has the highest density of universities and students in the US, also has knowledge-intensive industries such as life sciences, finance, consulting and IT. It seems constantly able to reinvent itself. The same can be said for San Francisco, whose entrepreneurial culture breeds incremental entrepreneurship. The Indian cities of Bangalore, Hyderabad and Ahmedabad have benefited enormously from their world-class institutes of technology and management. Successful cases of post-industrial renewal, such as Boston, Pittsburgh, St Louis and Gothenburg (Sweden) seem to stress education and connectedness – in the sense of strongly linking their educational institutions to the wider city and the wider world.

# III. GVCs, competitiveness and the trade agenda

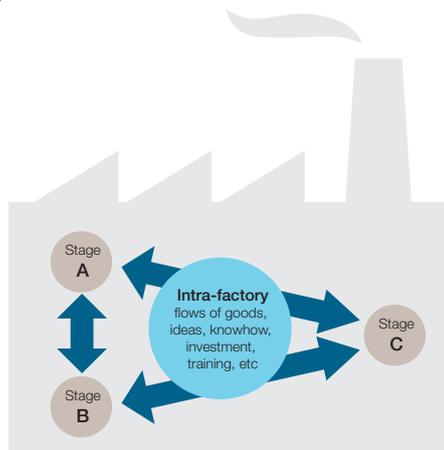
## The new globalization paradigm

Traditional trade involved made-here-sold-there goods crossing borders. The rise of GVCs means that trade is increasingly focused on helping countries, regions and cities make things, not only sell things. In a nutshell, GVCs should be thought of as factories crossing borders. Production stages that were previously organized inside a single factory are now dispersed internationally (Grossman and Rossi-Hansberg, 2006).

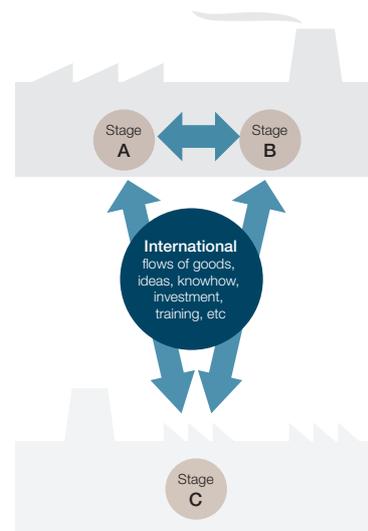
This transforms the world's competitiveness landscape by broadening the scope of cross-border flows. Trade no longer means only goods crossing borders. With factories crossing borders – especially borders separating advanced economies and emerging economies – the flows of goods, investment, services, people and ideas that used to happen inside developed-nation factories are now part of international commerce. The contrast is illustrated schematically in Figure 1.

**Figure 1:** GVCs turn intra-factory flows into international commerce

Traditional production



GVC production



Source: Richard Baldwin's elaboration

## GVCs, industrial development and competitiveness

These new flows transform development prospects by opening a new industrialization pathway. Countries that industrialized in the 19th and 20th centuries had to build full supply chains domestically before becoming competitive internationally. Today's rapidly industrializing nations invert the order. Instead of building the whole supply chain domestically to become competitive internationally (the 20th-century way), developing nations can join GVCs to become competitive. They can industrialize by "densifying" their participation in these international production networks.

This is how they can establish indigenous industrial capacity and diversify into services niches as well. This can happen faster if bottlenecks to GVCs are removed. However, GVCs are not a magic wand. They open doors, but most of the hard work of creating goods jobs has to be done at home with domestic reforms that address existing market and government failures and improve the ability of markets to efficiently reallocate resources to boost investment, jobs and growth. Creating good jobs requires opportunities, but it also requires good workers and an economic environment that allows them to seize these opportunities.

The flipside of this new industrialization pathway is a new competitiveness paradigm for developed and developing

nation firms. GVCs are a powerful new tool for leveraging firms' advantages, which shifts the competitive landscape. Globally competitive firms leverage their firm-specific know-how by setting up international production networks to produce inputs in the most cost-effective locations. Firms that have not joined the GVC revolution struggle to compete with those that have. No 100% made-at-home product can compete with goods that combine the best of, for example, US, Japanese and Chinese comparative advantages. This is a key element in the new set of trade-offs.

The value chain for Apple products provides graphic examples of how this works. Expanding high value is created at home (in California and elsewhere in the US) through R&D, marketing, logistics and after-sales service. A vast ecosystem of apps is a telling illustration. Many East Asian countries have found niches with sub-contractors making parts and components for iPhones, iPads, Macs and now the Apple Watch. So have software programmers in India. And China has its foot on the lower rungs of the GVC ladder with assembly operations from which Apple products are shipped abroad. But this is not a static state. As comparative advantage evolves, one should expect the richer coastal regions of China to move up the value chain, thereby opening new opportunities higher up and lower down the value chain for other countries, regions and cities – translating into all-round gains for jobs, productivity and growth in rich, middle-income and poor parts of the world.

In short, the GVC revolution has denationalized comparative advantage. This has changed the options facing developing and developed nations, and cities and regions within them.

## Implication for national growth and jobs policies

Conceptually, growth is simple. Raising living standards year after year requires workers, farmers, technicians and managers to produce higher value year after year. This, in turn, requires more and better “tools” year after

year. Here “tools” mean: human capital (education, skills, training, experience); social capital (trust, rule of law, sense of fairness and inclusion); physical capital (machines, infrastructure); and knowledge capital (technology, product development).

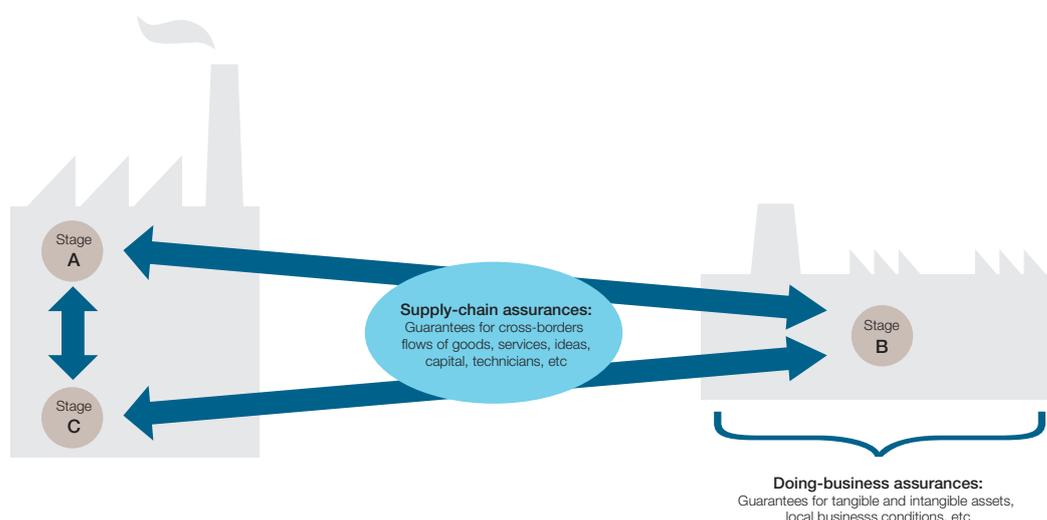
Pro-jobs, pro-growth policies must foster investment in human capital, social capital, physical capital and knowledge capital – and ensure that it is deployed wisely. The rising importance of GVCs – though they are not a magic bullet – can help governments with these tasks. They can help developing nations overcome bottlenecks, but they complicate government policy-making because they involve, by definition, private-sector decision-making of actors in several countries. But for these same reasons, GVCs leverage the effectiveness of policy reforms.

In some sense, GVCs are a new potential source of good jobs for developing countries, but they only create opportunities. National policies, from education policy to urban policy, still need to ensure that the nation has workers that can fill the jobs. And as the country densifies its participation in GVCs, the skills of the workers have to rise if the GVC activity is to spread beyond simple unskilled work. Creating good jobs is a task that requires workers whose profiles are appropriate to the jobs that are to be created. If a country has only unskilled workers, the GVC jobs that come to the country will naturally be only unskilled ones.

## Trade policies to underpin GVCs

Because GVCs are factories crossing borders, the trade pillar of a 21st-century growth strategy involves elements that a 20th-century thinker might view as having nothing to do with trade. GVCs produce jobs and growth by recombining human, social, physical and knowledge capital of several countries, so the pro-growth policies are different from those in a world where all the “tools” come from domestic sources.

**Figure 2:** Two categories of assurances underpinning international production-sharing



Source: Richard Baldwin's elaboration

For developing countries, fostering GVC participation needs to go beyond the education and labour market policies. To attract GVCs, developing countries need to provide two categories of assurances:

– Supply-chain assurances

These underpin connections among production stages; i.e. the trade-investment-service-IP “nexus”. As the study “Enabling Trade: Valuing Growth Opportunity” (World Economic Forum, 2013) demonstrates, improving two key supply chain barriers – border administration and transport and communications infrastructure and related services – would pay enormous benefits. Global GDP could increase by \$2.6 trillion and exports by \$1.6 trillion if countries moved national policies halfway to global best practices.

– Doing-business assurances

Firms setting up production facilities abroad – or forming long-term ties with foreign suppliers – expose their tangible and intangible assets to new risks. Threats to such assets hinder GVC participation and slow the attendant growth in trade, investment and jobs.

For developed-economy governments, establishing such assurances is key to leveraging competitiveness. While offshoring is controversial in many countries, it really should be thought of as a type of technological progress. After all, offshoring means the domestic industry can produce more per domestic worker. Just like any technological innovation – think of how many jobs were lost when cars replaced horses – GVCs often cause dislocation. If developing country governments want to maintain broad support for these changes, they need to ensure that the gains and pains of these changes are shared widely. While nothing is assured as a matter of pure logic, a recent study shows that US outward FDI is good for US domestic production, employment, exports, and R&D (Hufbauer, Oldenski and Schott 2013).

## 21st-century trade and investment policies and the way forward

The restructuring of global production – what Marcel Timmer and co-authors call the GVC Revolution (Timmer et al, 2013) – trigger cascading changes. First, international commerce – especially cross-border flows of goods, services, know-how and investment – changes. Second, trade and investment governance options change since the types of disciplines that were appropriate for made-here-sold-there goods are not sufficient to underpin internationalized production networks.

Setting up these new GVC disciplines is a win-win proposition, so they often arise spontaneously. Some of the pro-GVC policies are packaged into “deep” regional trade agreements (RTAs). Others are in the tangle of bilateral investment treaties (BITs) that have been signed between advanced economies and developing and emerging economies. A very important component of the new disciplines, however, comes from autonomous or unilateral reforms undertaken by developing countries which seek

to join supply chains by improving competitiveness. This triad of new disciplines has been called “21st-century regionalism” (Baldwin, 2011, 2014).

Many pro-jobs, pro-growth reforms require national action only. Some of the supply-chain and doing-business assurances, however, work best when they are locked in by international agreements. There is, again, a strong link between trade and competitiveness.

To understand what should be done requires avoiding the trap of using 20th-century paradigms to think about 21st-century regionalism – 20th-century RTAs were mostly about tariff preferences. As one nation’s preference is another’s discrimination, 20th-century thinking viewed RTAs as creating “mercantilist allies” – who enjoyed trade creation – and “mercantilist enemies” – who suffered trade diversion. Yet tariffs today are low worldwide on high-volume items, and goods for which tariffs are still high are routinely omitted from RTAs. Deep RTAs are about internalizing the new cross-border externalities created by the internationalization of production. The whole trade creation/diversion thinking is misleading when it comes to many aspects of 21st-century regionalism.

This lack of discrimination – what might be called “soft preferences” – is intrinsic. Many deep RTA provisions impinge on firms, services, capital and intellectual property (WTO, 2011). Discrimination is technically difficult since it is hard to define the nationality of firms, services, capital and IP in today’s world – at least in a way that precludes low-cost circumvention. In other words, the “rules of origin” for deep provisions are leaky. As a result, we should not think of 21st-century regionalism as being mostly about discrimination.

Despite the lack of hard discrimination, RTAs and, in particular, the mega-regional trade agreements under negotiation, when concluded may have implications for non-members not only in terms of regulatory coherence but also from a systemic perspective. In this context, the preservation of an inclusive multilateral trading system is relevant, including closing the Doha Round and moving towards a discussion of new topics for the WTO negotiating agenda.

# IV. Final remarks - On strengthening trade and competitiveness: why now?

Trade and competitiveness are integral to spur growth, productivity and job creation. At a time when leveraging the world economy is growing ever more complex, fostering openness at the global, regional and national levels, and at the same time strengthening key domestic factors at home, should be key priorities for leaders across developed and emerging economies and developing countries more broadly. Trade success is fundamental for a country's economic competitiveness, and competitiveness in turn boosts the success of firms and economies in global trade, in particular to integrate into GVCs. Without further progress in trade agreements, pressures for improvements in productivity and innovation will be lessened. Without further progress in competitiveness resulting in clear trade wins, industries and their leaders may decide to go the easy route and lobby for protection, subsidies and patronage. The virtuous cycle of trade liberalization and competitiveness could easily become a vicious cycle of protectionism and stagnation.

This is thus a timely discussion for (at least) four reasons.

1. Since the 2008-2009 crisis the world has remained largely in a crisis management mode. Fighting the fires ignited by the crisis was necessary, but this happened without sufficient attention to the supply side and structural issues in the global economy. A new agenda of better trade and competitiveness policies – and more linkages between the two – would help address this shortfall.
2. Although there are the signs of energy in global trade negotiations discussed above, there is evidence that more needs to be done to tackle barriers to integration. The causes of the weak trade growth since the crisis are complex and, in part, may reflect structural changes in the economy, but this should not lead to a fatalist approach (Constantinescu et al, 2015). It underlines the importance of a new effort to address barriers to deeper integration. Although there was not the rush to raise protectionist barriers during and after the crisis that some expected, the evidence of a creeping protectionism is becoming clear, with non-tariff barriers increasingly becoming a serious threat to the effective and productive deployment of global supply chains. With each semi-annual report of trade and investment measures submitted to the G20 by international organizations, the stock of barriers is growing, with governments putting barriers in place much faster than they are being taken away (WTO, 2015). Issues associated to cyber-security have recently become the latest manifestation of the interplay of “high” and “low”

politics, coming to the forefront as some of the most complex elements to tackle under trade and investment rules. (Draper and Lawrence, 2015).

3. In many developed and developing economies, there is a long list of competitiveness reforms yet to be undertaken. Indeed, distortions to factor and product markets have accumulated since the recent global financial crisis, and market reforms have slowed down as attention has shifted to macroeconomic stimulus and fire-fighting. Efforts are under way – for example, China's efforts to boost the services economy and rebalance growth, or India's drive to tackle some of the key constraints on its competitiveness – but these are tentative. There remains fundamental unfinished business.
4. More positively, the potential for gains to growth, innovation, job creation and development through deeper integration may be relatively untapped. The same is true for the potential of digital trade to connect millions to the global marketplace. The constant increase in technological innovation is leading to more complex GVCs and new opportunities for firms to connect to cutting-edge, high value-added economic activities.

The potential is clear. As the global economy evolves, the threads connecting policies once termed “behind the border” and those beyond are becoming ever stronger. At the same time, the reach of these policies from international to subnational and even city administrations has grown. There have been few moments in modern history when this agenda has been more timely – and when action has been more urgently needed.



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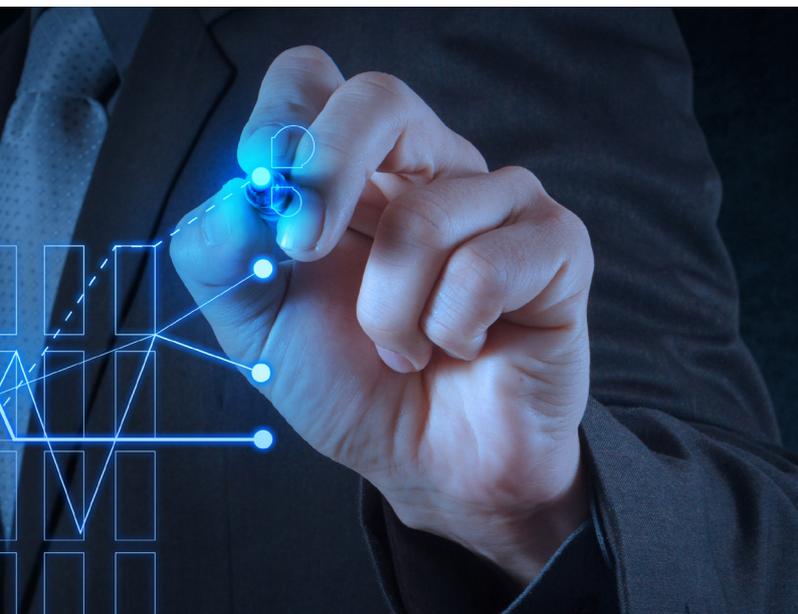
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