GEGAFRICA
GLOBAL ECONOMIC GOVERNANCE

DISCUSSION PAPER | JULY 2016

SMEs AND GVCs IN THE G20

IMPLICATIONS FOR AFRICA AND DEVELOPING COUNTRIES

Peter Draper & Chiziwiso Pswarayi

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ABOUT GEGAFRICA

The Global Economic Governance (GEG) Africa programme is a policy research and stakeholder engagement programme aimed at strengthening the influence of African coalitions at global economic governance forums such as the G20, BRICS, World Trade Organization and World Bank, among others, in order to bring about pro-poor policy outcomes.

The second phase of the programme started in March 2016 and will be implemented over a period of three years until March 2019.

The programme is expected to help create an international system of global economic governance that works better for the poor in Africa through:

- undertaking substantial research into critical policy areas and helping South African policymakers to prepare policy papers for the South African government to present at global economic governance platforms;
- ensuring that African views are considered, knowledge is shared and a shared perspective is developed through systematic engagement with African governments, regional organisations, think tanks, academic institutions, business organisations and civil society forums; and
- disseminating and communicating research and policy briefs to a wider audience via mass media and digital channels in order to create an informed and active policy community on the continent.

For the next three years the work of the programme will be focused on three thematic areas: development finance for infrastructure; trade and regional integration; and tax and transparency.

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ABSTRACT

Increasing the participation of developing countries in global value chains (GVCs) is now an accepted G20 priority that features prominently on the Chinese government's agenda for the 2016 summit. However, there is disagreement over a simple question: how can multinational corporations (MNCs), which drive GVCs, be persuaded to incorporate small and medium enterprises (SMEs) from developing countries into the GVCs they co-ordinate?

The debate over this question is first explored in broad outline. It comes down to a decision by each country on whether it wishes to utilise GVCs in its growth strategy and, if so, what measures it wishes to adopt to promote the incorporation of its firms into MNCs' GVCs. The choice ranges from conscious industrial strategies oriented towards coercive measures designed to force MNCs to integrate SMEs into their value chains, to facilitative approaches designed to attract MNCs to invest and, over time, incorporate domestic suppliers into their value chains where it makes business sense to do so.

Next we turn to the analyses and prescriptions being proffered by key international institutions in relation to the evolving G20 agenda on including SMEs in GVCs. What clearly emerges is consensus on a number of key constraints that inhibit the growth of SMEs in general and their inclusion into GVCs in particular. These can be summarised in three broad areas:

- transaction costs (import tariffs; border procedures; logistics; trade finance);
- network infrastructure (information and communications technology [ICT]; transport; energy); and
- capacity (of firms, to meet GVCs' standards; and of supporting government institutions).

We conclude by noting that the most controversial aspect of this agenda relates to market access policies, whereas the rest is likely to enjoy support in both South Africa and sub-Saharan Africa. Such support is already built into the Aid for Trade agenda being co-ordinated by the World Trade Organization (WTO) and other institutions. Therefore, our key recommendation is that market access considerations should be removed from G20 deliberations so as not to obstruct progress on the broader, horizontal agenda identified above. Finally we proffer a high-level framework for the South African government's consideration, summarised in Table 1.

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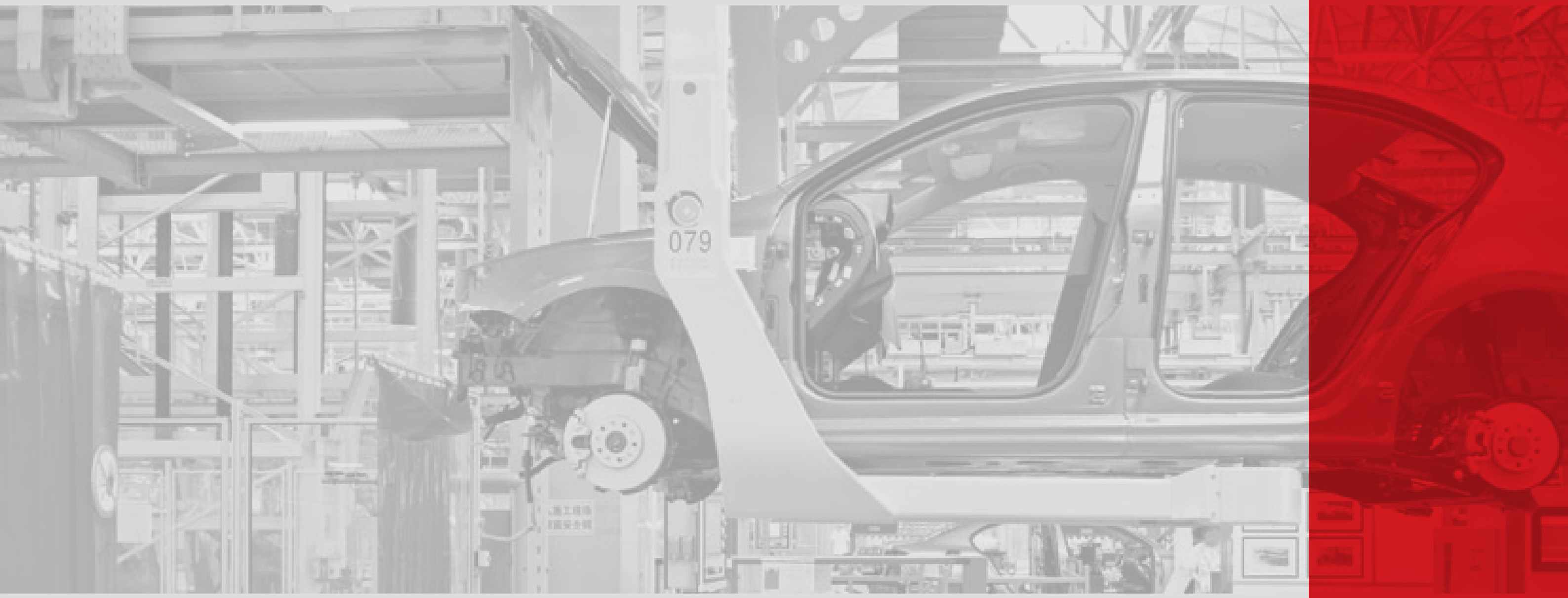


BACKGROUND

Since the St Petersburg summit in 2013, the G20 has established an agenda designed to promote the inclusion of SMEs in GVCs. This culminated in the official launch of the World SME Forum (WSF) by the G20 Turkish presidency in Istanbul on 23 May 2015, in partnership with the International Chamber of Commerce (ICC), the Union of Chambers and Commodity Exchanges of Turkey, and the World Chambers Federation. Furthermore, the following key points emerged from the Turkish presidency's G20 Action Plan:

- the importance of identifying and implementing a comprehensive and multi-faceted policy agenda that would pave the way for firms of all sizes, in countries at all levels of economic development, but particularly in developing countries, to take full advantage of GVCs;
- the agreement that services sector reforms should constitute a pivotal element of the G20 trade agenda;
- the importance of streamlining existing regulations;
- the continued need for strong G20 political support for the ratification of the WTO's Trade Facilitation Agreement (TFA);
- the need for the development of a G20 SME Action Plan; and
- the need for improving access to finance for SMEs, as a critical enabler of their participation in GVCs.

China has emphasised the importance of this agenda in its pre-summit documents. Specifically, in relation to these issues the Chinese G20 website states:[1]

> The G20 should work toward the GVCs that benefit all, and explore the possibility of formulating initiatives aimed at strengthening capacity building and policy coordination to substantially improve participation of SMEs, as well as developing countries, in GVCs and their capabilities to trade and invest. Moreover, the G20 needs to build a rules-based GVCs system that is both consistent and inclusive.

Some G20 participants attach substantial importance to this issue. However, as is clear from the above, the agenda is very broad. Consequently, establishing a cohesive G20 agenda on these matters is no simple task. Furthermore, international opinion on what would constitute an appropriate rules-based GVC system is polarised, with policymakers in South Africa and some African countries being sceptical of the proposals offered by developed countries and some international economic institutions. In addition, many African policymakers prefer to emphasise regional value chains (RVCs) over GVCs, regarding the former as being more conducive to the emergence of firms indigenous to the continent given the less onerous requirements for participation in RVCs.

In this light, the paper first reviews, in broad outline, key contours of the global debate on GVCs and what they imply for trade and investment policies. Broad implications for SMEs wishing to integrate into, and upgrade within, GVCs are also developed.

The paper then relates the broad positions of key international institutions on the matter. These institutions represent large and small businesses, and international governmental agencies charged with developing policy perspectives on the issue. Broad implications for SMEs are drawn from this survey, and related to the debate previously charted.

Finally, South African, and to some extent African, realities are compared with the policy perspectives emerging from the international institutions surveyed, in light of the GVC policy debate. The paper concludes with recommendations for the South African government.

THE DEBATE OVER GVCs

In recent years the role that GVCs can play in economic development has been widely acknowledged. There is also an emerging debate on the kinds of policies required for developing countries to integrate into GVCs, with a view to upgrading within them. Since GVCs are co-ordinated by large 'lead firms' or MNCs that have stringent requirements vis-à-vis their suppliers and well-established supplier networks, this generally means that it is difficult for SMEs to access GVCs.

1 G20 Summit 2016 China, 'Theme and key agenda items of the G20 Summit in 2016', 1 December 2015, http://www.g20.org/English/China2016/G202016/201512/P020151210392071823168.pdf, accessed 19 July 2016.

Furthermore, G20 members are divided on the kinds of policies required to promote SME participation in GVCs. These divergences centre on whether the broad policy package should emphasise facilitative, liberalising approaches whereby MNCs are encouraged to include SMEs in their value chains, or whether MNCs should be compelled to do so.[2]

In order to (briefly) unpack these issues, we first delve into the nature of GVCs.

The nature of GVCs and their economic implications

The GVC paradigm in trade theory implies that the comparative advantage of a country or a region is changing much faster than before. Countries and firms no longer specialise in producing the entire product in question; rather the international division of labour has become much more complex. Value chains are parcelled out into tasks and allocated to different countries and firms according to their comparative advantage positions. This opens many opportunities and challenges for firms and workers both in developed countries and the emerging world, as their competitive situation is changing much quicker than it used to.

According to Cattaneo *et al.*,[3] they see four detailed paradigm changes due to the emergence of GVCs:

- A change of the relevant strategic focus from countries to networks, GVCs, or 'lead firms'.
- A change of the unit of analysis from industries to tasks and functions. In the new GVC world, the movement of factors of production is being replaced by the movement and exchange of skills and tasks;
- An enormous increase in the speed with which goods are produced and sold, which means that knowledge has to be written off faster and acquired continuously; and
- A change of relevant barriers and stimuli from public to private. This reinforces the move of trade policy from taxing goods and services at the border to a broader set of 'behind the border' measures.

These changes mean that at the national level trade and industrial policies are becoming more difficult to 'target' since decision-making has become more decentralised. In the past, when countries aimed to replicate entire value chains domestically, it was possible to introduce broad import substitution policies, for example, without delving into the minutiae of where key components were sourced. Now, in order to maximise overall competitive advantages from a trade

2 The following analysis draws on Draper P & A Freytag, *Who Captures the Value in The Global Value Chain? High Level Implications for the World Trade Organization, The E15 Initiative: Strengthening the Global Trade System*. Geneva: ICTSD (International Centre for Trade and Sustainable Development) & WEF (World Economic Forum), July 2014.

3 Cattaneo O *et al.*, 'Joining, Upgrading and Being Competitive in Global Value Chains', World Bank Policy Research Working Paper, 6406. Washington DC: World Bank, April 2013.

policy perspective, fast, cheap access to reliable intermediate goods has become essential, and those often need to be supplied through imports.

Furthermore, the increase of trade in services has become apparent, with foreign direct investment (FDI) flows shifting from the secondary to the tertiary sector. Firms are increasingly outsourcing parts of their business functions. Services multinationals are also establishing services GVCs in their own right. Furthermore, the operation of GVCs increasingly depends on the availability of supportive services, which have become a key component of value-addition across different types of value chains.[4]

These changes can be used to identify the challenges ahead. They are particularly important from the perspective of developing and emerging economies that want to upgrade in GVCs. These challenges are sharpened by the fact that GVCs are not evenly distributed, and not all countries are equally placed to integrate into or upgrade within them. Next, we reflect on some of the key challenges developing countries in general face in integrating into, and upgrading within, GVCs.

How are GVCs distributed?

The geographical location of production processes is shifting as comparative advantages shift. GVCs have been concentrated in what Richard Baldwin terms 'Factory North America', centred on the US; 'Factory Europe', centred primarily on Germany; and 'Factory Asia', centred on Japan. In recent decades China has been the world's central player in international production fragmentation, serving as the key location for processing and assembling manufactured goods.[5] However, with rising Chinese labour costs, and the so-called 'Fourth Industrial Revolution' centred on information technology developments including automation, production is relocating, partly back to the US[6] or to countries such as Vietnam, Cambodia and Mexico.[7]

This relocation process offers, in theory, opportunities for developing countries in, for example, Africa, where factor costs are likely to be lower than in emerging economies. Countries in Africa with cheap, productive and plentiful supplies of labour, for instance, could attract labour-intensive parts of GVCs.

4 WEF (World Economic Forum), *The Shifting Geography of Global Value Chains: Implications for Developing Countries and Trade Policy*. Geneva: WEF, 2012.

5 WTO (World Trade Organization), *Trade Patterns and Global Value Chains in East Asia: From Trade in Goods to Trade in Tasks*. Geneva: WTO, 2011.

6 Sirkin LH, Zinser M & D Hohner, *Made in America, Again: Why Manufacturing Will Return to the US*, BCG (Boston Consulting Group), August 2011, https://www.bcg.com/documents/file84471.pdf, accessed 19 July 2016.

7 Draper P & R Lawrence, 'How should sub-Saharan African countries think about global value chains?', *Bridges Africa Review*, 2, 1, 2013.

However, it also poses threats to new locations, such as the poaching of qualified workforce or environmental damage, and thereby may meet resistance in governments and non-governmental organisations in developing and developed countries.

Much depends on the kind of GVC being considered. At the broadest level, services, manufacturing and resources GVCs encompass widely diverging economic activities; require very different skill sets; have very dissimilar investment time horizons; and therefore integrate very differently into host-nation environments. These sectoral dimensions interact very diversely with host-nation attractiveness, which also varies widely.

Consider the matter from an MNC point of view, in which locational decisions are the dominant criterion. The primary issue in location choice is what motivates the investment. Traditionally three motives are identified: resource seeking; efficiency seeking; and market seeking.

If the purpose is to extract natural resources for export from the host nation, then the investor is not likely to consider horizontal investments into ancillary activities unless these are wholly lacking and the investment could not proceed without them. The onus is therefore on the host nation to ensure sufficient rents are earned from resource exports through taxation so that developmental investments can be made in the broader economy.

Efficiency-seeking investment consciously seeks to access low-cost, productive labour and takes advantage of broader efficiencies in infrastructure and logistics, to mention two key services. Some kinds of efficiency-seeking investments, such as in the clothing industry, are very low margin activities and consequently remain sensitive to marginal cost increases. Therefore, such investment is footloose and not likely to leave a sustained development impact in and of itself. It follows that host nations attractive to this kind of FDI need to actively promote upgrading possibilities, leveraging off the initially positive developmental impacts of this kind of investment. Other kinds of efficiency-seeking investments, such as logistics or transportation companies seeking to leverage strategic locations, can be more enduring and have wider, more positive developmental impacts. This requires different responses from the host nation.

Market-seeking FDI is generally there for the long haul and is consequently the most sustainable. Over time MNCs investing for this purpose are likely to locate more of their tasks into the host nation, and into its broader region through constructing RVCs. The latter are likely to interact positively with logistics, transportation and distribution services to deliver wider developmental outcomes. Of course, market-seeking FDI may also compete with domestic firms, threatening their profitability and, possibly, their survival. Offsetting this negative potential impact is the fact that market-seeking FDI should raise the productivity of competitors in the host nation, and in suppliers that integrate into the MNCs' value chain.

In conclusion, it is clear that GVCs are not identical, and that host nations do need to consider this in making choices about how to interact with MNCs.

Broad contours of the debate

The international emphasis on GVCs has given rise to suspicions in some developing countries and parts of the broader trade policy community. The argument is that what some term the 'GVC narrative' is essentially a prescription for developing country liberalisation amounting to the widely criticised 'Washington Consensus' package, and through that to securing developed country preferences in the Doha Round and beyond.[8]

The fact that the core of the policy agenda associated with the GVC narrative consists of trade and investment liberalisation is therefore seen to favour Western MNC interests

The core of the controversy is not hard to understand. GVCs are driven by MNCs predominantly headquartered in developed countries. The policy agenda associated with the GVC 'narrative' is proffered by institutions that are either dominated by developed countries – the Organization for Economic Cooperation and Development (OECD) through its Trade in Value Added Initiative and to a lesser extent the World Bank[9] – or are perceived to be unduly influenced by developed countries – the WTO through its 'Made in the World' initiative. The fact that the core of the policy agenda associated with the GVC narrative consists of trade and investment liberalisation is therefore seen to favour Western MNC interests, which would benefit from a broadly liberalising deal arising from the Doha Round. Consequently, in a negotiating environment as contested as the Doha Round, critics were bound to arise.

But the critics go further than the Doha Round dynamic to make their case. Central to their critique is inherent scepticism over the purported benefits of FDI by MNCs for host countries. A broader questioning of trade liberalisation as a policy approach reinforces this scepticism. Indeed, rather than embrace trade and investment liberalisation per se, in this line of thinking active industrial policy led by autonomously embedded states[10] is the preferred policy approach. Proponents argue that this is the real lesson to learn from East Asian success,

8 Ismail F, 'Towards an alternative narrative for the multilateral trading system', *Bridges Africa*, 2, 2, 15 May 2013; South Centre, 'Global value chains: Unpacking the issues of concern for developing countries', *South Bulletin*, 77, 4 February 2014, pp. 20–26.

9 Cattaneo O *et al*., *op. cit*.

10 Evans P, *Embedded Autonomy: States and Industrial Transformation*. Princeton: Princeton University Press, 1995.

rather than the liberalising logic proffered by the GVC narrative. In this industrial policy logic, 'strategically managing' MNCs in host nation environments, inter alia through screening FDI and imposing performance requirements, is essential. Similarly, protecting domestic firms in order to build indigenous industrial capacity is advocated. It follows that in the WTO context liberalisation should not be embraced for its own sake, but has to be more strategically engaged and co-ordinated with domestic industrial development imperatives as defined by the state, hopefully in partnership with (domestic) business.[11]

We turn now to three key issues in the debate, in order to illuminate the broader policy debate.

Entrapment in comparative advantage?

Since resources are furthest upstream in GVCs, it follows that simply extracting and exporting them does not generate much value for the economy. Adherents of this view do not have much faith that ancillary, particularly downstream, development will take place spontaneously. Therefore, critics worry that developing country resource exporters risk becoming embroiled in 'resource traps',[12] and consequently advocate diversification out of resource exports into higher value-adding activities, especially manufacturing. In order to encourage domestic value addition, or 'beneficiation' as it is termed in South Africa, various coercive instruments are advocated, ranging from export to FDI restrictions. This 'resource nationalist' perspective is gaining currency around the world.

It follows that a policy agenda simply advocating trade and investment liberalisation is anathema to adherents of the resource diversification view.[13] The term 'liberalisation' implies loosening controls and allowing market forces to determine outcomes, rather than outcomes being determined by conscious, state-led design. The primary objection to the GVC narrative, therefore, is that its liberalising impulse will entrap developing countries in resource-intensive comparative advantage.[14]

11 Asche H, Neuerburg P & M Menegatti, 'Economic Diversification Strategies: A Key Drive in Africa's New Industrial Revolution', UNIDO (UN Industrial Development Organization), Development Policy, Statistics and Research Branch, Working Paper 2/2012. Vienna: UNIDO, 2012.

12 These can take various forms, from the 'Dutch disease' whereby resource exports generate high foreign exchange receipts leading to currency appreciation and consequent curtailment of manufactured exports, to conflict traps wherein weak states are hostage to competing political forces seeking to control the resource in question for patronage purposes. See Collier P, The Bottom Billion: *Why the Poorest Countries Are Failing and What Can Done About It*. Oxford: Oxford University Press, 2007.

13 These adherents may not object to all trade and investment liberalisation measures. They may advocate a more nuanced and focused liberalisation regime.

14 dti (Department of Trade and Industry), 'A South African Trade Policy and Strategy Framework'. Pretoria: dti, May 2010.

A variant of this view holds that while it is all very well to enter into GVCs in non-resource areas, particularly manufacturing, the political economy of value chain management makes it difficult for new entrants to upgrade within the value chain.[15] This is a function of lead firm–supplier power dynamics, in which MNCs allegedly keep their suppliers in subordinate positions. So, even if 'beneficiation' is pursued, the logical implication of this variant is that it will be difficult for outsiders to integrate into manufacturing value chains centred on upstream resources, as MNCs control those value chains.

The evident success of modern resource exporters such as the US, Australia, Sweden, Chile and Botswana suggests there is more to the story than the resource trap literature implies

The counter-arguments to these views are many. Most importantly, the notion of resource traps is contested. Bauer[16] argues that if resources, or poverty, really 'trapped' countries then Europe would still be stuck in the Stone Age. Morris *et al.*[17] draw on Hirschmann's[18] notion of linkages and argue that backward, forward and horizontal linkages have developed around resource extraction projects in the resource dependent economies they study. The evident success of modern resource exporters such as the US, Australia, Sweden, Chile and Botswana suggests there is more to the story than the resource trap literature implies. Central to this is what happens to the rents derived from resource extraction. If they are invested in economy-wide cross-cutting enablers that upgrade conditions for business as a whole, positive outcomes are entirely foreseeable. Much depends on governance capacities and arrangements in the host nation. Finally, MNCs evidently do integrate various suppliers into their GVCs, provided those suppliers meet the rigorous requirements. So it is possible to diversify out of resources, but this requires focus, effort and sometimes government support.

Nonetheless, the notion that resource extraction is inherently exploitative and unsustainable is widely held. This highlights the importance of equity considerations in the GVC debate.

15 Goger A *et al.*, 'Capturing the Gains in Africa: Making the Most of Global Value Chain Participation', Duke Center on Globalization, Governance and Competitiveness, February 2014.

16 Bauer P, *From Subsistence to Exchange and Other Essays*. Princeton: Princeton University Press, 2000.

17 Morris M, Kaplinsky R & D Kaplan, *One Thing Leads to Another: Promoting Industrialisation by Making the Most of the Commodity Boom in Sub-Saharan Africa*, 2012, http://www.prism.uct.ac.za/Downloads/MMCP%20Book.pdf, accessed 13 July 2016.

18 Hirschmann A, *Essays in Trespassing: Economics to Politics and Beyond*. Cambridge: Cambridge University Press, 1981.

Iniquitous outcomes?

This concern applies primarily to labour-intensive GVCs, such as clothing, footwear and the assembly phase of electronics. A graphic manifestation of this concern was the tragic collapse of buildings and factory fires in Bangladesh in 2012 and 2013.[19] These events highlighted the egregious safety and human rights concerns associated with operating in the cut-throat clothing industry. The fact that much of the value and profits associated with the clothing–textiles–retail value chain are captured by the MNC retailers that drive this GVC reinforces perceptions that the gains are unevenly distributed, while the human cost can be high. Closer to home in Africa, Ethiopia has experienced tremendous gross domestic product (GDP) growth over the last decade, averaging 10%, and exceeding the sub-Saharan average of 5%. This is in substantial part owing to Ethiopia's diversification drive focused on increasing manufacturing exports, and its increasing access to labour-intensive GVCs such as footwear and coffee. Nonetheless, some critics note that co-operative farmers of speciality coffee, for example, get approximately 7% of the retail price (versus 4% for non-cooperative exporters).[20] Clearly much more could be done to benefit producers at the bottom of the value chain.

Many observers also worry about the footloose nature of this pattern of FDI, since it is driven by low costs. Once wages are bid up in the current favoured location, MNC investors will relocate to the next favoured destination. The core concern, then, is that the erstwhile host would not have built sufficient domestic value addition capability to reorient its participation in that GVC, notably to upgrade or diversify into other productive activities.[21] Furthermore, while the wage structure would have improved, and people would have been employed in low wage activities for a while, some worry that the country risks becoming caught in a middle-income trap, unable to make the transition to higher levels of development.[22] In addition, the low-wage jobs would have moved on.

The notion of a middle-income trap is contestable on the same intellectual grounds as resource or poverty traps.[23] Most GVC proponents would recognise these concerns. Regarding the ethical environments characteristic of low-wage, assembly-driven GVCs, proponents note that MNCs, primarily from developed countries,

19 There are many international media articles on these events, which are summarised in Wikipedia, '2013 Savar building collapse', https://en.wikipedia.org/wiki/2013_Savar_building_collapse, accessed 19 July 2016.

20 Afribiz, 'Industrialization and global value chains in Ethiopia', July 2014, http://www.afribiz.info/content/2014/industrialization-and-global-value-chains-in-ethiopia/, accessed 19 July 2016.

21 Goger A et al., 'Capturing the Gains in Africa: Making the Most of Global Value Chain Participation', Duke University Center on Globalization, Governance & Competitiveness, February 2014.

22 Spence M, *The Next Convergence: The Future of Economic Growth in a Multispeed World*. New York: Farrar, Strauss and Giroux, 2011.

23 Bauer P, *From Subsistence to Exchange – And Other Essays*. Princeton: Princeton University Press, 2000.

operate under various codes of conduct promulgated at national and multilateral levels. In principle, MNCs' home nations should enforce these codes, although that is not a given. Nonetheless, domestic pressure groups do so too, principally through generating negative publicity that can lead to consumer boycotts, for example. Furthermore, forums such as the OECD offer platforms for peer review in which violations of adopted codes or standards are tackled. Clearly more could be done. However, while home states may be responsible for governance failures – policing their own MNCs – arguably developing country host states are equally, if not more, at fault. In this light, principally domestic companies, not MNC

Essentially, the business of attracting MNC FDI into host nations is akin to a beauty contest, in which the contestants all try to outdo each other in order to be noticed, and favoured, by the MNC 'judges'

manufacturers or retailers, perpetrated the Bangladesh tragedies. As in the case of resource governance, this highlights the role of the MNC host state in regulating and enforcing domestic working conditions, which in the Bangladesh case left much to be desired. While the MNC retailers were divided in their responses to the tragedy, both firms in the US and the EU did sign commitments to improve working conditions in Bangladesh. Developing country MNCs by contrast often do not operate under the same ethical constraints.

Regarding concerns over upgrading for example, targeted investments into training facilities in the industry concerned can also make a difference. If approached collaboratively the MNCs' global network could be leveraged towards this end, since MNCs are acutely conscious of the need to acquire skilled employees in order to prosper in the global marketplace. Of course, the level of commitment of the MNC is contingent on how it views its investment in the host nation, and particularly whether it is there for the long haul. Furthermore, in the process of incorporation into GVCs, even at the lower end, some skills and technologies are likely to be transferred. The more absorptive the domestic environment is, the more likely this will lead to upgrading. That highlights the importance, again, of investment into cross-cutting enablers, particularly education and training, by the host nation. Finally, many international studies over the years have shown that Western MNCs generally provide better working conditions and pay more than domestic companies.[24]

Race to the bottom?

This argument derives from the liberalising logic inherent in the GVC perspective. Essentially, the business of attracting MNC FDI into host nations is akin to a beauty

24 Bhagwati J, *In Defense of Globalization*. New York: Oxford University Press, 2004.

contest, in which the contestants all try to outdo each other in order to be noticed, and favoured, by the MNC 'judges'. This means, inter alia, providing ever more liberal policy environments, since that is what MNCs presumably want.

The logic of providing generous incentives is particularly prevalent in the manufacturing sector, but also applies in certain services GVCs, notably finance and the attraction of headquarters FDI. It could have substantial implications for the host nations' overall fiscal position as tax holidays, fiscal incentives, local government grants, etc. become increasingly generous in a competitive 'race to the bottom' of the fiscal pool. Such an outcome would have deleterious consequences for necessary developmental expenditures, such as building infrastructure, implementing redistributive social transfer schemes, or the crucial business of maintaining and developing the state's institutional capacities.

International investment promotion experience suggests that while incentives play a role in FDI location decisions, they are probably not decisive

This argument is essentially one for adopting sensible incentive packages. GVCs' proponents are presumably in favour of that. Furthermore, international investment promotion experience suggests that while incentives play a role in FDI location decisions, they are probably not decisive.[25] Strategic factors, notably comparative advantages, competitive advantages and the overall orientation of the host state towards FDI, are more important. Regarding comparative advantages, the truth is that large parts of the developing world are not favoured locations for manufacturing FDI since their comparative advantages lie elsewhere.[26] Similarly, in terms of competitive advantages the decisive determinant is arguably institutional capacities in the economy at large, and in the state in particular. And of course MNCs are not likely to go where they are not wanted, nor where the investment environment is unattractive.[27] Finally, few countries possess the market power to impose strong conditions on MNCs – China and Brazil come to mind.

25 Authors' personal experiences in working in a policymaking environment, and in participating in training courses for investment promotion officials, endorsed by a senior official from Nestle who participated in a study group session at which this working paper was presented.

26 Draper P & R Lawrence, *op. cit*.

27 WEF, 2012, *op. cit*.

Focus on regional value chains instead?[28]

In Africa, as with other regions, some policymakers and analysts argue that, rather than prioritise attracting MNCs into the region with a view to integrating into GVCs, the focus should be on constructing RVCs. These would favour incorporation of firms indigenous to the region, since the requirements for participation in such value chains are lower than those that MNC lead firms impose. This leads logically to the view that MNCs should be discouraged from investing in the region, in other words, to extending import-substitution into a regional frame. Furthermore, it is argued that many of the policy preferences advanced by proponents of the GVC narrative, particularly proposals for regulatory change, could be better addressed at the regional level through regional economic communities in the African case.

Opponents of this perspective counter with three arguments. First, indigenous firm capacities in most African states and regions are weak, and so it is difficult to see how RVCs could be driven by these weak private sectors outside of South Africa, where the private sector has relatively strong capabilities. The well-known controversies surrounding a prominent South African retailer, Shoprite, and its difficulties in sourcing goods within the African countries it has invested, demonstrate the weakness of African private sectors. It is difficult to envisage African private sectors driving RVCs.

It is difficult to envisage African private sectors driving RVCs

Second, if the facilitative perspective on policies required for integrating into GVCs is accepted, then the same logic applies to RVCs – in other words, liberalisation is more likely to encourage regional firms to make the desired investments. Of course, should restrictive approaches be favoured at the national level then logically adherents to such approaches would also seek to project them into the region. In the end, the controversy here remains one of ideological orientation towards MNCs in general, regardless of whether they originate from the region or outside.

Finally, critics of regional economic integration processes in Africa, and developing countries more generally, note that the institutional arrangements in question tend to remain weak and shallow, and as such are not real laboratories for the kinds of policy reforms required to facilitate cross-border value chain investments – whether of the GVC or RVC variety.

28 These arguments are reviewed in Draper P *et al.*, 'Is a "Factory Southern Africa" Feasible? Harnessing Flying Geese to the Southern African Gateway', World Bank Working Paper, 102983, 1 January 2016, http://documents.worldbank.org/curated/en/2016/01/25840684/%E2%80%98factory-southern-africa%E2%80%99-feasible-harnessing-flying-geese-south-african-gateway, accessed 19 July 2016.

High-level implications for SMEs in developing countries

In light of the debate reflected above, developing countries face a strategic choice regarding their stance on MNCs and GVCs.[29] Much depends on the country's comparative and competitive advantages and economic policy orientations. In general, effective integration into GVCs offers the potential for employment creation and broader development opportunities, notably for women. Clearly, though, the scope of such opportunities is linked to the kind of GVC in question. Arguably, the absence of such integration would lead to negative effects on economic growth and development, with negative impacts on the poor and women. But the key question still remains: how to integrate into GVCs?

Effective integration into GVCs offers the potential for employment creation and broader development opportunities, notably for women

The core policy prescription advocated by critics is for developing countries to formulate conscious industrial strategies. This approach is gaining ground in key parts of the developing world, including Africa.[30] These approaches are more sophisticated than those prevalent in the 1960s and 1970s, in which crude import substitution combined with 'picking winners' to deliver generally poor outcomes. Central to them is the notion of 'deliberative targeting', in which the state consults actively with business in an iterative process of identifying key blockages to domestic industrial development so that the strategy emerges from the bottom up, rather than the top-down approaches pursued earlier.[31] This is analogous to Hausmann et al.'s notion of 'self-discovery' of the blockages to development in particular industries, and the broader notion of identifying the 'binding constraints' or bottlenecks blocking economy-wide industrial development.[32] Interactions with MNCs are not excluded a *priori*; indeed in the Rodrik/Hausmann/Velasco perspective they may be critical.

In addition, the overarching strategy should inform targeted promotional efforts led by well-resourced and politically powerful investment promotion agencies (IPAs)

29 OECD (Organization for Economic Cooperation and Development), 'The Participation of Developing Countries in Global Value Chains: Implications for Trade and Trade Policy', April 2015, http://www.oecd.org/tad/tradedev/Participation-Developing-Countries-GVCs-Policy-Note-April-2015.pdf, accessed 19 July 2016.

30 UNECA (UN Economic Commission for Africa), 'Economic Report on Africa 2013: Making the Most of Africa's Commodities – Industrializing for Growth, Jobs and Economic Transformation' 2013; Asche H, Neuerburg P & M Menegatti, *op. cit*.

31 Asche H, Neuerburg P & M Menegatti, *op. cit*.

32 Hausmann R, Rodrik D & A Velasco, *Growth Diagnostics*, John F Kennedy School of Government, Harvard University, 2005 (revised), http://www6.iadb.org/WMSFiles/products/research/files/pubS-852.pdf, accessed 19 July 2016.

that conclude bargains with key lead firms in selected GVCs. Relations with MNCs in different GVCs would presumably be filtered through the lens of their perceived value addition to the domestic economy. It follows that screening capacity is required in the state, preferably in the IPA, to determine whether the MNC in question is likely to add value. One key consideration in this regard is the MNCs' willingness to engage in developing local suppliers as part of establishing their investment footprint. Some go further and advocate coercive policies, such as imposing local content requirements on MNCs in order to oblige them to source domestically, including from SMEs. However, the success of such policies depends on, inter alia, the institutional qualities of the state, the general availability of entrepreneurship and skills in the country, the overall regulatory compliance burden for SMEs in the putative host market, and the market power the country has relative to MNCs that have other choices.[33]

Adopting the kinds of regulatory changes advocated by adherents to the GVC narrative could well lead to a 'race to the top', to the extent that regulatory reforms are sensible and promote better governance

Moreover, in our view governments should minimise political barriers to trade and investment. This includes tariffs, subsidies and other non-tariff barriers. This would enable MNCs targeted for inward FDI to establish their tasks in the host nation as efficiently as possible, thus maximising sustainability and linkage potential, with a view to incorporating SMEs into their value chains. Linkage potential is likely to evolve over time, as the MNC acquires familiarity with the host country market, and the business advantages of sourcing locally become apparent. Furthermore, such linkage/sourcing potential could be positively incentivised through various government programmes, such as tax incentives or direct grants, as part of the process of encouraging the MNC to relocate to the host country. Taking account of the 'race to the bottom' debate highlighted previously, such incentives packages need to be carefully designed so as to minimise the impact on the fiscus. Furthermore, in our view adopting the kinds of regulatory changes advocated by adherents to the GVC narrative could well lead to a 'race to the top', to the extent that regulatory reforms are sensible and promote better governance.

In this light we turn now to identifying the constraints holding back development of SMEs in general and inhibiting their participation in export markets, via GVCs or otherwise.

33 Observations made during the study group meeting at which this paper was presented.

THE THRUST OF THE G20 AGENDA: POSITIONS TAKEN BY KEY INTERNATIONAL ORGANISATIONS

In this section we briefly review inputs into the issue, provided by key private sector and inter-governmental organisations that are active in the process of inputting into G20 positions. The focus is on the blockages to enhancing SMEs'[34] participation in GVCs and in exports more generally. The emphasis is on private sector perspectives, since it is the private sector that drives value chains. In the final section we synthesise key policy recommendations emerging from the review.

International Chamber of Commerce

The ICC, following the Bali Business Forum in 2013, has increasingly acknowledged and become more active in affirming the value of SMEs as independent entities in national economies, as well as their role in GVCs.[35] The ICC notes that GVCs are a dominant feature in an ever-changing integrated global economy.[36] SMEs account for 95% of all firms and 60% of employment worldwide.[37] It states that 80% of global trade value occurs in GVCs, which are co-ordinated by MNCs, whereas approximately 40–50% of export values are contributed by SME suppliers within GVCs. Within developing countries, the ICC finds that SME participation in GVCs is of particular importance, as smaller firms can represent as much as 80–90% of employment.[38]

With such high discrepancies in SME inclusion into GVCs, national government policies and measures are found to be the key drivers in promoting the necessary growth within developing countries

Nonetheless, the ICC finds that there are clear discrepancies in SME participation in GVCs. In the Association of Southeast Asian Nations trading bloc, for example,

34 There are as many definitions of SMEs as there are authors/organisations writing about the subject. Hence we do not attempt our own definition here, but take it for granted that there will be an acceptable definition at country levels, and that these will be broadly comparable across jurisdictions.

35 ICC (International Chamber of Business), 'ICC World Trade Agenda: Post- Bali Business Priorities', June 2014.

36 *Ibid*.

37 ICC, 'ICC Banking Commission Global Survey highlights impact of trade finance gap on SMEs', September 2015a, http://www.iccwbo.org/News/Articles/2015/ICC-Banking-Commission-Global-Survey-highlights-impact-of-trade-finance-gap-on-SMEs, accessed 19 July 2016.

38 *Ibid*., p. 3.

the share of SMEs participating in GVCs is estimated to vary between 6% and 46% depending on country [39] and presumably the GVC being measured. With such high discrepancies in SME inclusion into GVCs, national government policies and measures are found to be the key drivers in promoting the necessary growth within developing countries.

In this light, the ICC finds that industrial tariff reduction and eventual elimination, as pursued in some measure in the Doha Round, will particularly help developing countries.[40] Regarding Africa specifically, the ICC affirms that the implementation of the WTO TFA could reduce the cost of trading internationally by over 15%.[41]

Furthermore, in a survey done by the ICC Banking Commission in 2015, the ICC identified trade finance as a key issue for SMEs. The survey was completed by 482 respondents from 112 countries. It found that SMEs account for nearly 53% of all rejected trade finance transactions, whereas 79% of larger corporates were able to attain financing.[42] The survey also revealed that anti-financial crime compliance is a significant impediment to trade finance.[43] Financial compliance for SMEs is increasingly a matter of concern, rising from 69% of those surveyed in 2014, to 80% in 2015, and expected to rise to 95% in 2016.[44]

World SME Forum

As SMEs are often left on the margins of national development, the WSF [45] aims to be a platform where both national and international policies are brought to the fore to ensure a more inclusive and equitable world economy.[46] It was established during Turkey's presidency of the G20 in 2015, with the idea being to place focus

39 ICC , 2014, *op. cit*.

40 *Ibid*., p. 2.

41 ICC, 'The World Business Organization and Africa', Brochure, www.iccwbo.org/Data/Documents/news/Brochures/Special-Projects/ICC-in-Africa-_-EN/+&cd=2&hl=en&ct=clnk&gl=uk, accessed 19 July 2016.

42 ICC, 2015a, *op. cit*.

43 *Ibid*.

44 ICC, 'ICC calls on G20 to deliver four-point agenda for growth and jobs', 2015b, http://www.iccwbo.org/News/Articles/2015/ICC-calls-on-G20-to-deliver-four-point-agenda-growth-and-jobs, accessed 19 July 2016.

45 The forum is open in terms of membership. Founded through a partnership between the Union of Chambers and Commodity Exchanges of Turkey, the ICC and the ICC's World Chambers Federation, the World SME Forum (WSF) is a new initiative to drive the contributions of small and medium sized companies (SMEs) to global economic growth and employment. For further details see ICC, 'World SME Forum', 23 May 2015, http://www.iccwbo.org/worldwide-membership/national-committees/world-sme-forum/, accessed 19 July 2016.

46 G20, 'G20 Turkish presidency key messages', http://g20.org.tr/turkey-2015/key-messages, accessed 19 July 2016.

on the integration of SMEs and lower-income developing countries (LIDCs) into the global economy. The WSF places particular emphasis on increasing access to finance and reducing bottlenecks that impede the growth of SMEs.

By increasing access to cost-effective capital for states, there will be a trickledown effect to SMEs, particularly in the creation of private–public partnerships

By increasing access to cost-effective capital for states, there will be a trickledown effect to SMEs, particularly in the creation of private–public partnerships. Such measures would improve the regulatory framework and the efficiency of public investment, and support alternative sources of infrastructure investment such as asset-based financing.[47] Through broad-based infrastructure investment logistics, costs for SMEs will reduce while ICT access will improve. Both will assist SMEs in reaching global markets.

For the first time in Turkey there was a G20 energy ministers' meeting, which highlighted access to energy as a priority measure for SMEs. This was of particular significance in relation to sub-Saharan Africa, where the focus of discussions was on addressing energy constraints in the region.[48]

Business 20

Following the G20 summit in Turkey, the Business 20 (B20) identified two key themes in relation to SMEs: financial inclusion and improved global financial regulation. As previously mentioned by the G20, access to finance is routinely identified as a major barrier to SME growth. Information, however, may prove just as large a barrier. According to the B20 'Financing Growth Task Force Policy Paper' in 2015, there is a large deficit of data about SMEs. The policy paper therefore recommends that information on SME credit worthiness should be more available to reduce risk and increase appetite for SME financing.[49]

Economic confidence has not reached levels similar to those prior to the 2008 economic crisis. Financing of SMEs therefore must be reconceptualised beyond traditional bank lending. The B20 suggests that governments should broaden and deepen SME access to alternative financing as means to attaining growth in the global economy. Included in such methods that could be broadened are

47 *Ibid*.

48 *Ibid*.

49 B20 (Business 20), 'B20 Financing Growth Taskforce Policy Paper', September 2015, http://worldsmeforum.org/wp-content/uploads/2016/04/b20turkey_fgtf.pdf, accessed 4 May 2016.

supply-chain financing, crowd funding, hybrid financing instruments, leasing, capital market and private equity funding. In order to increase SMEs' access to finance, the B20 finds that the international community needs to improve the implementation of the global financial regulatory reform agenda, increasing the financial transparency and credit worthiness of SMEs. [50]

A concerted effort therefore needs to be made to improve SMEs' access to the digital economy, as well as to finalise the Information Technology Agreement

The B20 argues that the core means for promoting SMEs' integration into GVCs is through the WTO TFA, which, it claims, will create an estimated 21 million jobs, 18 million of which will be in developing countries.[51] In preparation for the agreement's implementation, the B20 finds SMEs need considerable help in reaching international markets. One such way is by supporting them to comply with international standards and improving their access through capacity building and technical assistance programmes. As technology becomes more efficient, the internet is an area in which developing countries still lag behind, although progress has been made. A concerted effort therefore needs to be made to improve SMEs' access to the digital economy, as well as to finalise the Information Technology Agreement.[52] By incorporating a five-year universal broadband connection target into G20 Member Growth Strategies, SME access to the digital economy can be made a priority for member states.

World Economic Forum

The World Economic Forum (WEF) recently issued a report on the broad topic of what companies want from the trading system, with particular focus on SMEs.[53] The report notes that what MNCs want from the trading system is not so different from what SMEs need: market access; rule of law; and a stable environment in which to do business.[54] In addition, MNCs are interested in the protection of intellectual property rights and rules governing services and investment. Furthermore, they wish to source and move a variety of goods, particularly

50 *Ibid*.

51 *Ibid*., p. 3.

52 B20, 'B20 Policy Proposals for the G20, Responding to the three I's, Inclusiveness, Implementation, Investment', September 2015, http://b20turkey.org/policy-papers/b20turkey_summary.pdf, accessed 4 May 2016.

53 WEF, 'What Companies Want from the World Trading System', September 2015.

54 *Ibid*., p. 6.

intermediate goods, around the world in order to lubricate their value chains, and therefore are strongly interested in reducing trade costs and times, translating into tariff reductions and a broad trade facilitation agenda. Finally, the report notes that MNCs are increasingly interested in anti-corruption measures being embedded in trade agreements, which speaks to the rule of law issue. Ultimately, the report notes that firms of any size are looking to grow revenues and contain costs.

Next the report notes that there are diverse national and regional circumstances concerning SME participation in international trade. SME participation in Asia seems to be the highest overall; unfortunately no comparative data for Africa is offered (and may not exist in any event). However, it also says that SMEs often resist liberalisation owing to the competition this is likely to bring, but argues that this resistance lessens as SMEs grow and participate in international trade. It provides a number of practical recommendations to governments for promoting SMEs' participation in international trade, including:

- boosting SME loan guarantee programmes to ease access to finance;
- establishing regional credit risk databases in order to promote transparency across borders, thereby easing the reluctance of financial institutions to consider lending to SMEs;
- working with MNCs to identify the latter's demand for goods and services, and providing matchmaking facilities, such as online platforms, to enable this;
- assisting SMEs to understand the myriad private standards that MNCs implement, and providing assistance with building the necessary capacities to adopt them so as to integrate into MNC value chains;[55] and
- establishing SME support centres to assist the latter with the basics of running businesses, and educating them in how to export and access MNC value chains.

It also notes that free trade agreements, which are typically negotiated with MNCs in mind, could incorporate chapters dedicated to promoting SMEs' participation. The Trans-Pacific Partnership has such a chapter, and one is reportedly under negotiation in the Transatlantic Trade and Investment Partnership.[56]

The report also interrogates the role of services in promoting SMEs. It notes that manufacturing as a share of GDP is shrinking across all countries, bar a few cases where it was low to start with. It also notes that the process of deindustrialisation, as occurred in advanced countries, is happening earlier in the development process while services are becoming more important sooner. In other words, the nature of the global economy has changed fundamentally, although this has yet to be grasped by development planners. The old notion that the services sector is unproductive relative to manufacturing has been turned on its head. As a result, policies that

55 *Ibid.*, p.15.

56 *Ibid.*, p. 10.

artificially promote one sector over another – industrial policies, in other words – should be abandoned in favour of promoting what the report terms the 'four Cs':

- connectivity to the world;
- cost containment;
- capacity enhancement (infrastructure and human); and
- confidence – maintaining the trust of investors.

These 'horizontal' measures are particularly relevant to SMEs. Unlike MNCs – which can build their own transportation infrastructure or buy out logistics companies, thus internalising costs, to take just two examples – SMEs are completely reliant on others to provide these four Cs.

The nature of the global economy has changed fundamentally, although this has yet to be grasped by development planners. The old notion that the services sector is unproductive relative to manufacturing has been turned on its head

Finally, the WEF[57] notes that trade finance has been lumped together with corporate asset valuations to determine overall capital and liquidity requirements. The effect is to significantly overstate risks in the trade finance terrain, leading to substantially increased costing thereof by banks that provide trade finance. This has led to substantial increases in compliance costs and to some banks' exiting trade finance markets, particularly in emerging markets. These developments have a disproportionate impact on SMEs and increase financial exclusion: hardly results that are in keeping with global efforts to promote the inclusion of SMEs in the trading system.

International Trade Centre

The International Trade Centre (ITC) also argues that implementation of the WTO TFA will be beneficial for SMEs globally, creating a more inclusive global economy by increasing national governments' accountability and SMEs' access to information, which are key areas that limit SME growth.[58]

Important for national economies as well as SMEs is their adaptability in an ever-shifting global economy. It is routinely cited that SMEs are less productive than

57 *Ibid.*, p. 16.

58 Dubai Exports & ITC (International Trade Centre), *From Export Promotion to Internationalization: The Role of Trade Promotion Organizations in the Evolving Global Economy*. Geneva: ITC, 13 May 2015.

larger firms, and that the latter pay higher wages. This is particularly true in developing countries, where markets are often small and exporters are collectively dependent on a relatively small number of primary products that are often subject to commodity price fluctuations. Furthermore, SMEs in developing countries export less than larger firms. For these reasons the ITC finds diversification and inclusion to be key measures for SMEs into the global economy. However, the ITC cautions that, although there has been much emphasis on the inclusion of SMEs into GVCs, and that this is good, there is also a risk of producers' being trapped at lower levels of production,[59] thus increasing SME inefficiency.

One measure that can address these risks is the Aid for Trade initiative.[60] Given necessary support, Aid for Trade can be effective in overcoming exclusionary barriers to trade such as logistics, electricity tariffs and internet connectivity.

The ITC also notes that service exports are seldom brought to the fore in relation to SMEs in developing countries. As many developing countries are predominately involved in the production of physical products, little attention is given to services. Between 50–70% of the world's GDP is services based, and approximately 45% of manufacturing comprises services inputs.[61] Therefore, capacity building of services sectors is an area where considerable export growth could lead to considerable SME growth.

Finally, the ITC notes that the increased inclusion of SMEs into GVCs and the global economy is linked with a concerted effort to encourage women into the workforce and entrepreneurship. This is based on the fact that women are more likely to invest in their communities and families.[62]

Organization for Economic Cooperation and Development and the World Bank

Following the G20 summit in 2015, the OECD and the World Bank issued a report on the challenges of making GVCs more 'inclusive' by overcoming participation constraints for SMEs and facilitating access for LIDCs. They suggest that SME participation in GVCs is mostly taking place through indirect contributions to exports, rather than through exporting directly, and that a holistic approach to trade, investment and national and multilateral policy action is needed to create more inclusive GVCs. The OECD is also undertaking comprehensive statistical and analytical work that aims to shed light on the scale, nature and consequences of international production sharing. It initiated the OECD Initiative on Global Value Chains, Production Transformation and Development, which is a platform for

59 *Ibid.*, p. 36.

60 Newfarmer R & M Nomer, *LDCs and Global Value Chains: Using Aid for Trade to Seize New Opportunities*. Geneva: ITC, 2013.

61 Dubai Exports & ITC, *op. cit.*, p. 46.

62 ITC, *SME Competitiveness Outlook*. Geneva: ITC, 2015.

policy dialogue and knowledge sharing between OECD and non-OECD countries.[63] The initiative aims at improving evidence and identifying policy guidelines to promote development by fostering participation and upgrading in GVCs.

According to the OECD's 'The Participation of Developing Countries in Global Value Chains: Implications for Trade and Trade Policy' note of 2015, there are a number of factors that determine GVC participation. Firstly, individual countries' structural characteristics play an important role, including their size, geographical location and manufacturing share in GDP. These appear to explain most of the variation in participation rates between countries. Secondly, policy factors greatly affect GVC participation. The note highlights that although tariff reduction is a step in the right direction for increasing trade, cross border customs procedures may ultimately impede the ease of trade beyond tariff reduction. It thus argues that the best policies promote deep integration, including trade facilitation, services liberalisation, competition policy, investment openness, intellectual property protection and dispute settlement. It also asserts that being open to inward FDI will further increase GVC integration.[64]

In relation to African GVC integration, the policy note argues that many countries on the continent find themselves without the scale and productivity to integrate effectively. This is further compounded by infrastructure and institutional quality. Although Africa has broadly experienced economic growth over the last decade, international companies routinely cite the absence of corruption, political stability, the credibility of reforms, and liberalisation policy initiatives as pre-conditions to doing business. These, taken together, lower the risk faced by suppliers, investors and exporters.[65]

Synthesis of perspectives from international organisations

It is clear from the review above that there is convergence on a number of key constraints, and associated remedies, facing SMEs as they look to integrate into GVCs and global markets more broadly. These are summarised in Figure 1.

Regarding transactions cost reductions, there is a clear consensus in the literature that import tariffs, particularly on intermediate goods, should be reduced where possible. Intermediate goods are the essential inputs into value addition processes, and can be thought of as the 'lubricants' of GVCs. Moreover, many intermediate goods require large-scale production processes – think of steel,

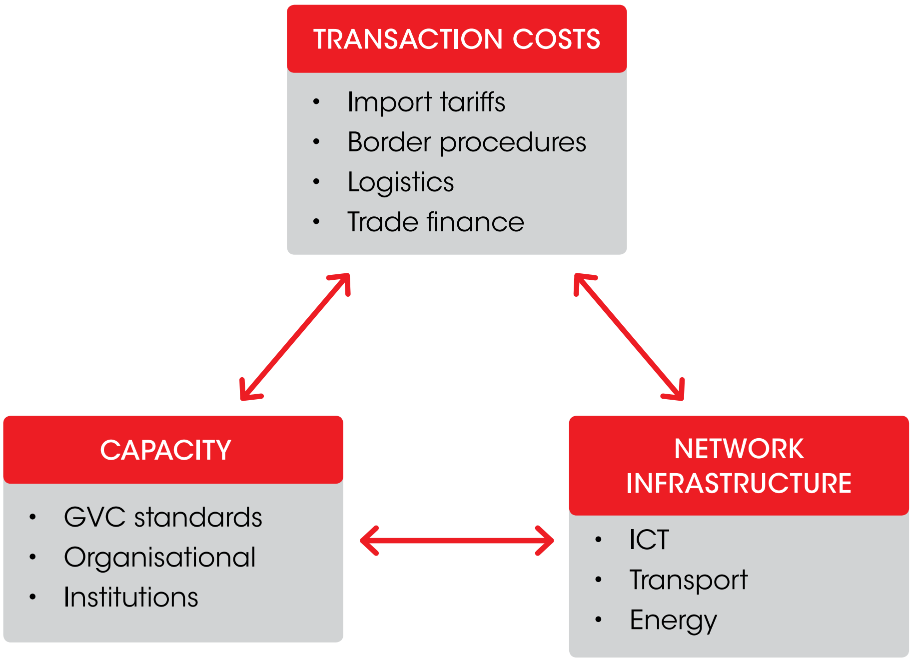
63 OECD, 'Global value chains', http://www.oecd.org/sti/ind/global-value-chains.htm, accessed 5 May 2016.

64 OECD, Trade and Agriculture Directorate, 'The Participation of Developing Countries in Global Value Chains: Implications for Trade and Trade Policy', April 2015, http://www.oecd.org/tad/tradedev/Participation-Developing-Countries-GVCs-Policy-Note-April-2015.pdf, accessed 5 May 2016.

65 *Ibid.*, p. 4.

for example – capacities that elude most SMEs. However, SMEs, particularly downstream producers, consume intermediates in order to produce final products.

FIGURE 1: KEY CONSTRAINTS ON SMEs' PARTICIPATION IN GVCs AND EXPORTS



Similarly, there is clear consensus on the need to streamline customs procedures, as captured in the TFA. At the same time, increasing the transparency of such procedures reduces opportunities for corruption and bureaucratic delays. In a world of just-in-time production this is essential to efficient delivery processes and favours all businesses, large or small.

Those delivery processes are contingent on efficient and cost-effective logistics or supply (as opposed to value) chains. Logistics is an essential service, as any exporter can attest to. Similarly, access to and the costs of trade finance are critical, but are also becoming more conditional and in relatively short supply as controls on bank finance generally are tightened. Still within the services domain, network infrastructure, notably ICT, transportation and energy, remain critical determinants of trade 'connectivity'.

Finally, the capacity of SMEs to integrate into GVCs and/or to export is conditional on internal organisational capacities, and the general institutional quality of the country within which they operate. Both are key determinants of the ability of SMEs to meet the high standards that MNCs expect of their suppliers, in the absence of which integration into GVCs is unlikely to take place. In addition, it is crucial that SME voices from African countries are heard in policy debates on these matters. Too often government officials represent their views in various international forums, in addition to which the business voice at those forums is generally grounded in MNC perspectives. Therefore, those G20 states interested in elevating the 'voice' of SMEs into G20 platforms should actively seek out organisations representing SME perspectives in their country, in order to canvass those concerns and effectively represent them. Furthermore, the G20, through official development assistance and working with governments in Africa, could support interactions between representative SME organisations at regional levels.[66]

Government policies can then focus on incubating the next generation of medium-sized companies from the current cadre of small companies

However, it is clear from the above that the institutions whose literature was surveyed essentially take the existing world of GVCs as given. In other words, the critical perspectives surveyed in the second section of this paper are absent. And so the various charges remain on the table, and are reflected in the positions being taken by some developing states in the G20 process, including South Africa.

In our estimation, however, the convergences are greater than the divergences. Critics would almost certainly agree with most of the core recommendations set out above. The key difference lies in market access, in two respects: for foreign goods to domestic markets, and of MNCs to domestic markets through investment. The rest essentially constitutes a business support agenda that resonates differently in different contexts, but resonates just the same.

Finally, it is questionable whether, in the African context, it makes sense to focus these interventions on small enterprises, which tend to be informal. It probably makes more sense to identify core groups of medium-sized companies that have realistic prospects for participating in GVCs, or RVCs for that matter, and work with them. Government policies can then focus on incubating the next generation of medium-sized companies from the current cadre of small companies.

With this in mind, we offer some recommendations for South Africa and Africa in respect of positions to take into the G20 Development Working Group process.

66 Observation made by a representative of organised business at the study group meeting where this paper was presented.

CONCLUSION AND RECOMMENDATIONS

The controversy in the GVC debate boils down to the orientation of the country concerned to economic globalisation. This is in flux across the world, developed and developing. It is thus not surprising that the institutions of global economic governance have been severely challenged from the standpoint of formulating agreed programmes of action and delivery in this area.

Given that these divergences are present in the G20, a sensible approach would be to focus on those areas where convergence is most likely. Leaving aside those elements of the agenda that focus on market access, particularly import tariff liberalisation and opening domestic markets to foreign investment, that still leaves plenty of room for convergence. Accordingly, we propose the non-comprehensive list in Table 1.

TABLE 1: RECOMMENDATIONS FOR SOUTH AFRICA'S G20 POSITIONS

THEME	ISSUES	RECOMMENDATIONS
Transaction costs	Border procedures	South Africa should support the ratification and implementation of the TFA.
		South Africa should assist African partners to make targeted capacity-building requests that support SME traders, especially women, and embed these in regional and continental integration processes.
	Logistics	Host governments and development assistance partners should support the organisation of 'self-discovery' discussion groups between key suppliers and medium-sized firms that use their services, with a view to enabling greater participation of SMEs in cross-border trade.
	Regulatory compliance	Development assistance partners should support measures to maintain SME participation in GVCs through tracking and reviewing regulation costs and compliance.
	Trade finance	G20 states should encourage the FSB to undertake a study of how existing regulations constrain distinguishing financial risks and trade risks and what can be done to promote trade finance for SMEs.
Network infrastructure (ICT, transport, energy)	Availability and cost	African countries should prioritise network infrastructure development in fiscal budgets at national and regional levels.
		Building on the outcomes of the Brisbane summit, development partners should leverage Aid for Trade and broader external funding support for infrastructure development in Africa.

THEME	ISSUES	RECOMMENDATIONS
Capacity to participate in GVCs	Meeting GVC standards	MNCs/states need to find ways to target incentives to SMEs to assist them to meaningfully participate in GVCs and compete.
		Similarly, development partners should assist African governments to work collaboratively with MNCs to build supplier relationships with medium-sized companies, in the first instance, in recipient countries.
	SME institutions	South Africa and G20 members should supply capacity-building support for institutions representing the voices of SMEs, particularly medium-sized firms with real participation potential.
		Development partners should assist African governments with resourcing SME development agencies.

Obviously these needs will vary from country to country in Africa. Nonetheless, most African countries, including South Africa, will recognise the importance of this agenda.

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