

IMPORTANCE OF GLOBAL VALUE CHAIN IN EMERGING MARKET ECONOMIES WITH SPECIAL REFERENCE TO INDIA

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ABSTRACT

The aim of this paper is to understand the meaning of Global Value Chain. What are the basic economic concepts that underlie this Theory? India lost out on the growth process when countries that form the so called 'East Asian Tigers', were rapidly moving on the path of development, due to the protectionist stand that the Indian Government had decided to adopt.

As the World Economy was entering a different phase of Liberalisation and Globalisation, it is important that India should be a part of it. China since it opened its doors from the 1980's has successfully used this concept to develop, and today has become a world power to reckon with. The paper researches the options that are available for India, and the way it can use its 'Demographic Dividend' effectively in increasing its Gross Domestic Product.

The pandemic has brought in its wake new sanctions against China, it is imperative that India steps into the shoes vacated by China and reap benefits in the form of high growth.

GLOBAL VALUE CHAIN: DEFINATION AND ITS IMPACT

Global value chains are a network of production processes that are spread across the world. This concept refers to the entire gamut of production activities that are involved in bringing out the final product. This includes processes right from the pre-production stage involving the design or even the concept of the product to postproduction i.e., the marketing and final distribution of the product. This concept essentially implies that value is being added at every stage of production. This meaning of 'value added' in development economics brings into focus the complete range of activities that have been undertaken to bring a product or service from the point of conception to its end use. More important is how these activities are distributed over geographic space and

across international borders. As we are living in an era of liberalization and globalization, the different stages in the production process could take place in any part of the world. It is very likely that the product in question is designed and conceptualized in a developed economy which involves a highly capital intensive set up. While some parts of the product that require labour intensive technology then may be manufactured in countries that offer cheap labour (or have a comparative advantage in labour) resulting in the production of the product at a much cheaper rate.

The term value added means that every time a product goes through any stage in production, some value is added to it. This value could be and is most likely added to the commodity as it passes from the raw material stage to the final one. This value that is added could be in the form of a tangible or intangible good. Intangible goods normally take the form of services that covers

- 1) services supplied from one country to another e.g., call center services
- 2) consumers or firms making use of a service in another country e.g., international tourism
- 3) a foreign country setting up subsidiaries or branches to provide services in another country e.g., a branch setting up a branch overseas
- 4) individuals travelling from their own country to supply services in another e.g., a consultant travelling abroad to provide Information Technology services.

The world of globalization and liberalization allows the different processes to be spread across the globe. This process basically works on the Theory of Comparative Advantage which was first propounded by the classical economist David Ricardo. The theory states that comparative advantage is an economy's ability to produce a particular good or service at a lower opportunity cost than its trading partners. This theory introduces opportunity cost as a factor for analysis in choosing between different options for production. A country has a comparative advantage in whichever good it sacrifices the least to produce.

Liberalisation and globalization have helped in expanding the reach of cross-border production, in the form of lower transport costs, advances in information and communication technology, and innovations in logistics (e.g., containerization). This development has largely been driven by transnational corporations (TNCs) in industrialized countries, who continuously restructure and reorganize their businesses in terms of quality and price so that they would be able to compete with other firms. This then forms the basis of relocating labour intensive stages of production from industrialised economies to low wage, labour abundant developing countries. Besides this

what is the new trend is “international outsourcing”, this means that part of the production process is manufactured by a third party which have no equity link to the original cooperation.

The Global Value Chain process is that process that could have both backward linkages and/ or forward linkages. Backward linkage occurs when say country A uses inputs from Country B for domestic production. Firms in country A can source inputs from country B through direct as well as indirect imports, this means that inputs are either supplied by local affiliated company of the TNC from country B or by locally owned firms that import inputs from other countries. It also means that factors of production could be imported, value added to it and then exported, to be a part of the Global Value Chain.

IMPORTANCE OF GLOBAL VALUE CHAIN IN CHINA’S GROWTH STORY

One of the most important countries that have successfully used the strategy of GVC, in recent times, to move on the path of development has been China. Looking in brief the trajectory that it followed, one can then set the stage for other emerging economies.

In the 1980’s China opened its frontiers to global markets, till then it was an unknown territory. The country in the last two decades or so has achieved miraculous economic growth, mainly due to its participation in the GVC. Joining global trade opportunities, presented a unique opportunity for rapid industrialisation in China. Instead of developing the whole chain, it specialized in those tasks in which it had a comparative advantage e.g., low-cost manufacturing capabilities, a huge scalable market due to its huge middle-income population, logistics and infrastructure improvements, and a favorable business climate completely aided by government efforts.

The Chinese government took a strong industrial policy stand, that it would guide the scarce resources coming into the country in those areas which would strengthen the economies absorptive capacity, along with encouraging technology transfers and aiding knowledge spillovers. The thought process was that, if initially they had participated in the GVC, with the manufacture of those commodities which required labour intensive technology, then as time progressed the economy should be able to manufacture those commodities which would be a part of the GVC that require more capital, and highly specialized technical knowledge. All of these would have to be developed within the country. This means that as time progressed the economy was able to move from a completely labour-intensive country to one which had developed its technical prowess in a manner that could compete with the best commodities that were being produced by highly developed nations. For emerging economies this has been a game changer with a definite roadmap for countries to achieve high growth rate. The reason that GVC has

helped the phenomenal growth of the Chinese economy has been 1) the era of trade liberalization 2) differentials between developed and emerging economies with respect to the cost of input factors (e.g., raw materials, infrastructure, marketing, logistics, social indicators like health and education), have facilitated these economies in joining GVC without having to develop the whole range of capabilities that are required for the complete process. It has essentially compressed the path to development.

One of the most important requirements for developing economies is the access to markets, so that the domestic industries could enjoy economies of scale. This became possible once the economy was part of the GVC. In the bargain these countries have been able to acquire skills, technology, as well as knowledge, all being extremely important for sustainable growth. With respect to the Chinese model of growth, the country directed the incoming FDI to those sectors which were lacking in technology so that knowledge transfer could take place. The basic assumption underlying this was a disciplined labour force.

PATH TO BE FOLLOWED FOR EMERGING MARKET ECONOMIES LIKE INDIA

In recent years i.e., between 2005-2015, there has been a steady decline in GVC intensity, mainly due to the Global financial crisis and the unfavorable impact of the Pandemic, but this does not take away the impact of GVC on sustainable development goals. For a country like India, to participate in the GVC would help in

- 1) Reduction of poverty, as well as continued augmentation of growth and employment
- 2) Cross country estimates suggest that a 1% increase in GVC participation could boost per-capita income by more than 1%
- 3) GVC participation could improve immensely firm level productivity improvements
- 4) Studies by the World Development Report of 2020 indicate higher level of labour productivity in those firms engaged in GVC participation.
- 5) In fact, firms that are engaged in both import and export are more productive than non-trading firms, or those firms engaged in only exports, and those engaged in only imports.
- 6) Backward linkages associated with GVC are particularly beneficial in increasing average productivity for an emerging market economy.

India's standing in the world has increased tremendously from 1990 onwards. Its share in world output (measured in US\$) has increased from 3.4% in 1990 to 3.2% in 2017 (World Bank 2020 Report). But its export performance has trailed. India's share in global merchandise exports is at 1.7% of world exports (World Bank Report 2020). The main reason for this being the export pessimism and import substitution strategy that India followed from 1947-to the late 1970's. This period was marked by the government following a policy of self-reliance and looking at domestic demand to provide the requisite incentive for growth of the manufacturing sector. This was achieved by import and export licenses; quantitative restrictions and license permits. As a result of these policies India lost out when the rest of the world especially the East Asian nations took advantage of the world opening. The East Asian economies used the Theory of Comparative Advantage, to produce and export commodities in which they had an advantage. This resulted in overall growth of the economies of Korea, Malaysia, Singapore, and Thailand. This is commonly referred to the phase of the growth of the 'East Asian Tigers'.

Since the 1990's, India has moved towards a more open approach. Adopting a more liberalized approach towards manufacturing, services sector, and even to some extent the agricultural one, with respect to industrial and trade policy. Implying, among other things a reduction in both import and export tariffs, as well as the abolition of 'licensing raj'. This led to a more competitive manufacturing and service sector, resulting in an export growth of 13.4% between 1990 and 2017, with the share of exports in GDP rising to 19.1%, (Center for Monitoring the Indian Economy..(CMIE)) for . Though the increase is quite substantial India is still trailing behind most of the East and Southeast Asian Economies. Exports have been able to deliver major development benefits to many economies, with respect to job creation, and poverty reduction. Exposure to global markets allow dynamism in firms to adopt new technology and thereby cut costs. As firms operate in world markets, they are facing higher demand which enables them to take advantage of economies of scale. Economists like Haddad and Shepherd (2011) have argued that no country in the past five decades, essentially since the 1970's have been able to maintain high living standards without increasing integration with the global economy.

India's share of foreign value-added content has steadily increased from 53% in 2005 to 61% in 2014. But there is still a long way to go to achieve sustainable growth. India's GVC growth during 2010 to 2017 has lagged of the other emerging economies, like Vietnam, Cambodia, and Bangladesh (which grew by more than 10% annually, while India's GVC exports increased by a meagre 0.9% in 2017). India needs to reverse this trend and increase its export target to \$800 billion by 2022-2023 as set out by NITI AYOJ (stated before the onset of the pandemic). For this target to be achieved it is imperative to improve GVC participation. This would require

identifying the key factors that influence GVC exports, taking cognizance of them, and outlining measures that would facilitate their growth.

In recent years especially just before and during the pandemic, several China-related actions have been taken. These have restricted Chinese foreign direct investment (FDI), excluding Chinese firms from bidding for Government contracts, indigenizing military production and reducing military imports, delaying clearing of goods and services coming from China, and banning Chinese technology apps and platforms. The look inward policy of protectionism comes from the belief that the era of globalization is over. But for India in particular, there is enormous potential to increase unskilled labour exports, which India is vastly under exploiting. India will be in a very good position to benefit from post-covid period. The pandemic has highlighted the issues involved when a country is dependent on only one source of supply. From 2015-2018 China has ceded export space of nearly 1% in low-skill labour exports. Studies have indicated that India's share of global labour force far exceeds low skilled exports. This means there is great potential for India to increase its low-costlabour exports (textiles and clothing) India should be producing an extra \$140 billion in these sectors (Chatterjee and Subramaniam 2020). The same authors have calculated that China has vacated about \$140 billion in exports in unskilled-labour intensive sectors, which include apparel, clothing, leather, and footwear. This advantage has not been adequately seized by India This is available for the asking, but it still requires a lot of hard work with respect to firms operating in India. They must become more competitive as well as keep a tight control on the quality of the products. The opportunity is there for the asking as one can see in the space vacated by China, but how well will India be able to move into the shoes vacated by China, will depend on the policies followed by the Government of India with respect to 1) labour Laws, 2) infrastructure Facilities3) credit facilities 4) tariff laws, to name a few.

It is quite apparent that China took advantage of the GVC, to achieve high rates of growth. This helped it to move from an economy which was initially involved in mainly labour-intensive commodities to capital intensive ones. India could attempt to walk this path and try and solve problems like 1) sustainable GDP growth, 2) reduction in unemployment, 3) reduction in poverty, 4) reduction in inequality. This seems an opportunity that the economy should take, if it wants to achieve all the above-mentioned goals, in the shortest period.

GVC can be facilitated by increasing the FDI in the country, as efficiency seeking enhances exports for sure, but along with-it comes expertise, technology transfer, research, and development, as well as economic upgrade. GVC participation also helps the local firms by enhancing their reach to global markets, helping the local firms reach standards of quality as required by international markets as well as aiding them in achieving economies of scale.

Besides the numerous advantages, there are disadvantages involved with respect to participation costs in GVC's, it could come with increasing income inequality. While interdependent firms in GVC'S benefit from sharing knowledge and technology, there are several instances when the lead or main firm restrict the transference of technology as well as preventing diffusion. It is also likely that GVCs benefit mostly large firms as they have better bargaining power to extract favorable terms from small domestic firms. The market power of the GVCs can also lock the emerging economies into low value-added segments thus restricting the positive spillovers from GVC participation. GVCs could raise environmental costs, if the developing nations push the production stages which have high carbon imprints to emerging economies which have lower environmental standards.

CONCLUSION

But despite the above disadvantages, the advantages weigh higher than the disadvantages. For India to achieve its goals of reduction in poverty, reduction in unemployment, as well as gainfully use the advantage of 'demographic dividend', it is essential that it should be a part of the GVC. To achieve this India is making a concerted effort. One of them is that India has negotiated for seven years to enter the regional Comprehensive Economic Partnership (RCEP) which caters to half the world's population to basically attract the GVCs that have spearheaded growth in many countries like Bangladesh and Vietnam and have largely by-passed India. It is such type of policy measures that will help India in integrating itself with GVC's and this would go a long way in fulfilling all its goals.

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