Task Force 3
Trade, Investment and Growth

Policy brief

MULTILATERAL COORDINATION AND EXCHANGE FOR SUSTAINABLE GLOBAL VALUE CHAINS

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Holger Görg Kiel Institute for the World Economy
Jann Lay German Institute for Global and Area Studies
Stefan Pahl German Institute for Global and Area Studies
Adnan Seric United Nations Industrial Development Organization (UNIDO)
Frauke Steglich Kiel Institute for the World Economy
Liubov Yaroshenko En Plus

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ABSTRACT

While participation in global value chains (GVCs) is widely associated with benefits for countries' development and growth, its environmental and social costs become increasingly evident. Representing core buyer and supplier countries in GVCs, the G20 is particularly suited to tackle this global challenge. We recommend the G20 should become a key global forum for exchange and collaboration on this important challenge, setting in place effective processes to ensure multilateral coordination for sustainable GVCs in the G20 and beyond.

CHALLENGE

An important share of global production takes place in global value chains (GVCs). Participation in GVCs is widely associated with economic benefits, such as productivity and job growth (World Bank, 2020). However, the sustainability of production in GVCs is increasingly contested, and the associated social and environmental costs can be large (see Delera, 2021 for a recent overview of the evidence). As production in GVCs means that multiple firms located in multiple countries have to jointly finalize goods and services, the sustainable governance of GVCs is best addressed in a coordinated multilateral effort.

The G20 member states already agree on a set of common standards on social and environmental sustainability dimensions. In 2017, the G20 endorsed the UN Guiding Principles on Business and Human Rights (hereinafter UN Guiding Principles), a significant cornerstone in recognizing and addressing labour conditions in global production. Moreover, as members of the International Labour Organization (ILO), all G20 members are represented in ILO's Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy (MNE Declaration). Eleven G20 countries are members of the Organisation for Economic Co-operation and Development (OECD), which adopted its Due Diligence Guidance for Responsible Business in 2018. G20 members are furthermore part of larger initiatives to address human rights and climate change (e.g., the Paris Agreement of 2015); and several countries adhere to business-oriented standards, such as UN Global Compact.

However, while the general endorsement of such guidelines is a crucial foundation, which should be reaffirmed by the G20, implementation of related country-specific national action plans (NAPs) is often relatively weak, with limited concrete steps towards sustainability agendas.[1] This may partly be explained by perceived or actual trade-offs between economic and sustainability objectives, which may be weighted very differently depending on individual country context and background. Most prominently, achieving environmental sustainability is often viewed as competing with economic growth, which remains a key priority, particularly in the Global South. In contrast, several G20 countries are already leading the way through ambitious NAPs and additional regulation that goes beyond domestic territory. The European Union (EU) has recently taken a stand on making domestic firms responsible for their entire value chain, which requires these firms to adhere to domestic standards even when operating abroad.[2] The United States currently has a blacklist in place that cuts off blacklisted firms or regions from value chains of US firms partly due to human rights violations.[3] Alongside these regulations, there is a wide variety of sustainability standards and labels that control and signal sustainable production, but so far mostly on a voluntary basis.[4]

Against this background of a diverse and sometimes even conflicting set of private and public initiatives, a key challenge is to coordinate approaches and balance diverse priorities, to identify best practices and stimulate exchange, and to provide support where needed. This calls for a multilateral approach and we therefore propose to establish the G20 as a key forum for exchange and coordination to achieve implementation of measures to address the global challenge of making global production networks more sustainable.

PROPOSAL

We propose that the *G20 becomes a key global forum addressing sustainability in GVCs*, putting mechanisms into place that allow for exchange as well as consensual but measured and tracked implementation of coordinated action.

RECOMMENDED ACTION I: PUTTING SUSTAINABILITY IN GLOBAL VALUE CHAINS ON THE AGENDA AND ESTABLISHING THE G20 AS A KEY FORUM FOR EXCHANGE AND COORDINATION FOR A LEVEL PLAYING FIELD

As an important step towards reaching sustainability goals, we call on the G20 to reaffirm the importance of sustainability in the context of GVCs and to discuss key priorities in achieving this. This reaffirmation builds on existing initiatives (e.g., UN Guiding Principles, ILO MNE Declaration, UN Global Compact) but the G20 should move beyond initial endorsements by integrating sustainability in GVCs into its regular agenda and become a key forum for exchange, coordination and cooperation. We recommend the Trade and Investment Working Group to take the lead, given its mandate to coordinate trade and investment activities for a swift recovery from the pandemic. Besides the economic recovery, trade and investment coordination in the context of sustainability in GVCs can make an important contribution to an environmentally and socially sound recovery. As this topic speaks to economic, social and environmental outcomes, it is of cross-cutting nature and thus also speaks to the mandates of the Development, Employment and Environment Working Groups.

This coordinated, multilateral approach is particularly relevant in the context of global value chains and is beneficial for at least two reasons: harmonization of approaches and standards to achieve sustainability in GVCs will assure a (i) level-playing field and (ii) reduce uncertainty.

Level-playing field. One argument against taking a stronger stand on social and environmental matters is that this might pose a disadvantage to countries not imposing such standards. The idea is that standards provide additional costs that cannot be passed through to consumers because the market for sustainable products is too small. In high-income countries, it is feared that large multinational enterprises (MNEs) that need to adhere to stricter standards cannot compete with (foreign) companies that focus only on cost competitiveness. In lower-income countries, one fears that the comparative advantage based on low labour costs erodes if strict standards are implemented. This might imply that lead firms divert from sustainable to cheaper suppliers, which tend to have laxer environmental and social standards (see also the discussion on pollution havens; see Copeland, 2008). On the other hand, one might argue that firms in countries that encourage the transition into sustainable production (either through regulation or state support) might gain a first-mover advantage, which pays off in the long run. In this view, laggards might be excluded from export markets in the future if firms are not prepared to comply with strict sustainability standards. Assuring a level-playing field through coordinated action addresses both those concerns.

Reducing uncertainty. Cross-country harmonization and the long-term perspective that come with coordinated approaches through multilateral cooperation furthermore reduce the uncertainty of firms. Currently, firms must plan for multiple scenarios across different markets and time periods. They may therefore be discouraged from making sustainable investments because they do not know whether such investments will pay off in the future. This stance holds back the transition into sustainable production and also hurts firms as they have to make uninformed investment decisions. Increasing certainty by establishing coordinated, reliable approaches is thus beneficial to all firms.

RECOMMENDED ACTION II: ESTABLISH REPORTING AND REVIEWING MECHANISMS WITH CORRESPONDING MANDATE FOR INTERNATIONAL ORGANIZATIONS

We call for establishing a mechanism to report on and review existing approaches to foster sustainability in GVCs, be it regulatory measures or voluntary standards. We propose to *mandate a consortium of organizations to review and to report publicly and annually on implemented measures*.

Potential candidates to fulfil this mandate are international organizations with leading expertise in international trade and investment and sustainability issues, including but not limited to the International Trade Centre (ITC), ILO, OECD, United Nations Conference on Trade and Development (UNCTAD), United Nation Environment Programme (UNEP), United Nation Industrial Development Organization (UNIDO), and World Bank. The mandated organizations would need to coordinate with existing initiatives, such as the UN Working Group on the issue of human rights and transnational corporations and other business enterprises.[5]

Throughout the process of reviewing and reporting, a set of important issues will need to be on the agenda and carefully considered. These include but are not limited to: (i) identification of and exchange on policies and best practices, (ii) evaluation of (unintended) consequences, including the role of small- and medium-sized enterprises (SMEs); and (iii) supporting the transition in developing countries.

(i) Identification of and exchange on policies and best practices

An exchange on existing initiatives and experiences is essential to facilitate the practical implementation of sustainability in GVCs. Several countries already have policies in place that can be taken as the starting point of the discussion (e.g., European due diligence laws; blacklist in US). While all approaches have similar goals, some will be more effective with differing repercussions for practical implementation. There are at least three areas of discussion that will benefit from exchange between all stakeholders: (i) monitoring and benchmarking sustainability in GVCs; (ii) evaluation of scope and liabilities of existing initiatives; and (iii) the efficient combination of private and public initiatives.

Monitoring and benchmarking sustainability in GVCs. Monitoring of sustainability is both a political and a technical discussion. Firstly, it raises the important question of international (minimum) standards versus domestic standards. A simple system would be that the international community agrees on a set of international standards, which are enforced through domestic legislation and regulation in each and every country. Yet if, as is the case for the European due diligence laws, buyer countries do not deem domestic implementation to be ambitious enough, countries and firms have to manoeuvre between domestic and foreign regulation. This requires important exchange by stakeholders to find efficient and consensual solutions. Secondly, this is a technical matter. This is especially the case if countries aim at monitoring all value chains crossing their territories, but it is also relevant for purely domestic approaches, such as when aiming to regulate and track informal suppliers to larger, formal firms and exporters. Businesses will need to find smart ways of tracking their supply chains to reduce costs, and states may need to be able to evaluate and measure performance of specific firms or value chains. Important questions that will need to be discussed relate to finding the right framework and technologies with which to track and measure sustainability within GVCs. It should also be discussed to what extent public efforts of monitoring and evaluating sustainability can help implementation of practices at the firm level.

Scope and liabilities. A related issue is the consistency of approaches with existing global rules. It would be important to uphold (or renew) trust in those global rules and in the new sustainability provisions by providing multilateral regulation that is supported by existing trade law. National due diligence laws, for example, apply across countries and thus could be in conflict with domestic regulations in supplier countries as they might disregard local standards or even violate the WTO's non-discrimination principle. Yet other approaches, such as blacklist approaches based on more and more criteria (such as sustainability clauses), may not be in line with WTO's non-discrimination principles. This is thus not to say that either of these approaches is unworkable but that these issues should be taken up multilaterally to find solutions that do not contradict international agreements and that provide a clear legal basis for companies and countries.

Combination of public and private initiatives. Given the emergence of a patchwork of voluntary and (different types of) mandatory sustainability standards that shape production and consumption practices, it will further be key to identify the most effective combination of public and private initiatives (from non-governmental organizations as well as the business sector). For example, public regulation might require firms to monitor and adjust the sustainability performance of their suppliers. This requirement, however, may in turn be certified by a non-governmental or private certifying agency that has the capacity to track specific value chains. For example, GlobalGAP is a private certifying agency that audits agricultural production and assess minimum standards. Many of these standards are at the same time minimum requirements of selling in the EU, and as such the GlobalGAP certificate is at least complementary to if not replacing state-led monitoring in several areas. There is thus already a host of experiences that can be leveraged to identify best practices, which will facilitate practical implementation.

(ii) Evaluation of (unintended) consequences

A typical first action resulting from policies aimed at fostering sustainable GVCs is to make sure that all production stages along a GVC follow the required sustainability standards. Yet to simply cut off suppliers that perform poorly and move all production to high-performing locations would hurt developing countries and put their economic development at risk. Existing suppliers should rather be enabled to produce sustainably. It is therefore important to evaluate so-called unintended consequences. There are at least three types of such consequences: (i) trade diversion; (ii) changes of industrial organization along GVCs; and (iii) effects for SMEs.

Trade diversion. Even under multilateral cooperation and coordination of policies, one might expect patterns of trade diversion. The basic idea is that shifting to sustainable production is costly. Those costs can either relate to increased monitoring or to the adoption of sustainable practices. If those costs differ across locations, specific locations or firms may become less attractive as a trade partner and are therefore less likely to be included in GVCs. Furthermore, one may argue that future investments in more costly locations will be avoided, which again may have negative economic consequences. On the other hand, one may also argue that the costs of switching to new suppliers are relatively high and that this may therefore be avoided by firms, such that enabling existing suppliers to adopt sustainable practices may be the more likely outcome (e.g., Antràs, 2021). Answering such questions is an essential empirical exercise that a review of existing initiatives needs to investigate as it entails important information on (economic) outcomes. Understanding why such trade diversion effects take place would further allow for more targeted answers, thus helping specific regions to achieve the transition to sustainable production without economic costs.

Industrial organization. The expected change in adoption and monitoring costs may also ignite changes in the industrial organization of GVCs, or their so-called GVC governance (e.g., Gereffi, Humphrey and Sturgeon, 2005). Firms might opt for new set-ups of GVCs that do more justice to the adjusted cost structure. For example, if lead firms have to monitor the sustainability of their suppliers, they might choose to interact with fewer but larger suppliers, if that saves costs. Lead firms might also revert from market (one-time) transactions to longer-term relationships or even to vertically integrated suppliers to source in-house. Such changes in GVC governance can have further implications, ranging from the extent to which technology is shared along the GVC to the possibilities of so-called upgrading of suppliers due to shifting power structures along the GVC. These second-order implications need to be considered in the review to understand how existing policies affect not only the intended social and environmental dimensions in the specific GVC but also the economic and social and environmental consequences in the supplier locations.

SMEs. SMEs are often specifically emphasized in development as they account for a large share of employment in both high- and low-income countries. Policies that disproportionally hurt SMEs might therefore lead to significant adjustment costs. It is therefore important to discuss whether SMEs might find it particularly difficult to adjust to new standards and if so, what could be done to facilitate the transition. One reason why they could be particularly affected by sustainability measures is that implementing sustainability standards in own operations and also monitoring sustainability in suppliers has economies of scale – that is, the cost of sustainability per unit of output reduces with increasing size of operations.[6] This puts small firms at a disadvantage compared with larger firms and possibly drive those firms out of the market, or out of GVCs. A possible solution to this is to find ways to allow SMEs to (i) make the required investments through public and private funds, or to (ii) find ways to share costs, such as through business alliances.

(iii) Supporting the transition in developing countries

While many of the G20 countries have the capacities to foster the transition to sustainable investment themselves, lower-income countries might find it difficult to bridge the short-term costs of such a transition. The international community should discuss ways of supporting countries with more limited capacities in at least two ways: (i) targeted development cooperation and (ii) leveraging of technology transfer through the private sector.

Development cooperation. Given capacity limitations, some of the above-discussed channels and challenges might be more pronounced in the context of developing countries. To acknowledge this, support for capacity building should be put in place. This could include assistance for identifying country-specific capacity limitations, support for effective participation of countries in the process, and support for the private sector for reaching agreed upon standards. For example, the transition to sustainable production and technologies might be held back as it requires coordinated action within countries. That is, the transition might, for example, require specific up- and downstream industries to make a specific firm's investment viable. Affluent states could take a coordinating role, but providing this environment can be challenging. Targeted development projects in, for example, the most important value chains of a country could be a starting point to facilitate the transition.

Technology transfer. Another important way of fostering adoption at the firm level is through the private sector. In particular, technology transfer within GVCs can be an important tool. In the developing-country context, there is, for example, ample evidence that MNEs often assist their suppliers in complying with standards, for instance via training or assistance (Javorcik and Spatareanu, 2009). It is important to discuss and understand under which circumstances MNEs are most likely to train their suppliers and what holds them back. Public–private partnerships may prove useful to foster this channel and to include the private sector to help adoption of sustainable practices in lower-income countries.

All in all, we see huge potential for the G20 to set the agenda for this important topic. The G20 is in the position to bring together important actors to make GVCs more sustainable. It is uniquely placed to provide a forum for exchange and for coordinated action that balances diverse priorities and objectives and that minimizes unintended harmful consequences.

NOTES

[1] Eight G20 countries have NAPs and five (Argentina, Australia, Brazil, India and Indonesia) are developing one. China, Russia, Saudi Arabia, South Africa and Turkey have not yet started implementation.

[2] The United Kingdom Modern Slavery Act addresses modern slavery and human trafficking by obliging large companies to monitor supply chains and report commitments. The Netherlands implemented the Dutch Child Labor Due Diligence Law in 2019. France and Germany have recently adopted due diligence laws covering all aspects of human rights violation and sectors, holding companies responsible for their supply chains. The European parliament voted for an EU-wide mandatory human rights due diligence (HRDD) law earlier this year.

[3] The US uses its blacklist (entity list, originally designed to prevent trade with companies that pose a security risk, e.g., production of weapons) to punish human rights violations. For instance, Chinese companies that are accused of relying on forced Uighur slave labour were added to that list recently.

[4] At the time of writing, 456 ecolabels exist in 199 countries covering 25 sectors, see www.ecolabelindex.com.

[5] This UN Working Group sets out to promote the dissemination and implementation of the UN Guiding Principles, and is preparing action plans for the upcoming decade.

[6] The current initiatives in Europe that hold their firms accountable for their suppliers (either the direct one or also indirect suppliers) only accrue to large firms. Importantly, however, this is not true for their suppliers, for which there is no size threshold.

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ABOUT THE AUTHORS

Holger Görg Kiel Institute for the World Economy

Görg is Professor of International Economics at the University of Kiel, Head of the Research Center "International Trade and Investment" at the Kiel Institute for the World Economy (IfW), and Director of the Kiel Centre for Globalization (KCG). He is also affiliated with the Tuborg Centre for Globalisation and Firms at Aarhus University, GEP at Nottingham University and IZA. His research interests are in empirical international trade and industrial organisation focusing in particular on the activities of multinational companies, FDIs, and international outsourcing.

Jann Lay German Institute for Global and Area Studies

Lay is Head of the Research Programme "Globalisation and Development" at the German Institute for Global and Area Studies (GIGA), Hamburg. As adjunct professor, he teaches development economics at the University of Goettingen. His work is on various facets of economic development in the Global South, in particular in Africa, including on foreign investment and global value chains, employment and labour markets as well as issues related to energy, climate and development.

Stefan Pahl German Institute for Global and Area Studies

Pahl is Research Fellow in the Research Programme "Globalisation and Development" at the German Institute for Global and Area Studies (GIGA), Hamburg. His research interests evolve around trade and structural change with particular emphasis on global value chains and issues related to economic, environmental, and social sustainability.

Adnan Seric United Nations Industrial Development Organization (UNIDO)

Seric is a Research and Industrial Policy Officer at the Department of Policy Research and Statistics of the United Nations Industrial Development Organization (UNIDO). Mr. Seric is currently leading the department's work on global value chains and foreign direct investments. His research has been published widely in peer-reviewed journals, books, special reports, policy briefs, and social media. Previously, he worked as an economist at the Organisation for Economic Co-operation and Development (OECD).

Frauke Steglich Kiel Institute for the World Economy

Steglich is a Researcher at the Kiel Institute for the World Economy (IfW), Managing Director of the Poverty Reduction, Equity and Growth Network (PEG-Net) at IfW, and Research Fellow at the Kiel Centre for Globalization (KCG). Her research interests lie in the field of empirical international economics and development, with a focus on foreign direct investment, global value chains, and corporate social responsibility.

Liubov Yaroshenko En Plus

Yaroshenko is an Associate Director at the Department for International Co-operation at En+ Group. She is responsible for the development of relationship with various business associations in North America and Europe, primarily those connected with combatting climate changes, supporting sustainable supply chains and discussing universal carbon pricing.