Supporting Supply Chain Trade

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October 5, 2013

Blurb: *Supply chain trade has benefitted many countries. But many others have largely been left out. Redesigning domestic policy formation processes and international cooperation can help expand supply chain trade*.

Many developing and transition countries have seen their exports of manufactured products grow rapidly in recent decades. The share of manufactures in total exports of developing countries has increased from just 30 percent in 1980 to over 70 percent today. A substantial proportion of this increase reflects so-called supply chain trade, with lower wage economies importing parts and components and processing them into products that are then exported for further processing in another country.

While all developing have benefitted from the high rates of growth that have been sustained by the "supply chain countries", most notably China, to date most of Africa and much of Latin America and the Middle East has not seen a significant shift towards the type of vertical specialization that has helped drive growth in East Asia, Mexico, Turkey, and Central and Eastern Europe. This matters because supply chains allow even poor countries to engage in manufacturing for the global market, because firms can locate labor-intensive and low-skilled tasks in those economies. SCT offers opportunities to exploit a nation's comparative advantages without having to develop vertically integrated industries that provide final good producers with the various intermediate inputs they need. Fostering greater diversification and participation in supply chain trade (SCT) can help create employment and increase incomes.

The design of supply chains is a function of many factors, some of which are not under the control of governments, such as geography. But many are. A key determinant of SCT investments is the level of trade costs that prevail in a country. Although traditional barriers to trade such as tariffs have fallen dramatically everywhere, average trade costs are much higher for low-income countries than richer ones. Trade and information/coordination costs help explain why a large share of global SCT is in fact regional –centered on three "international factories": Europe, East Asia and North America (Baldwin and Lopez-Gonzales, 2013).

Reducing trade costs and improving connectivity to regional and global markets is a precondition for attracting SCT investments. This is a policy agenda that revolves importantly around trade facilitation – improving the efficiency of border management – but goes beyond it to include policies ranging from regulation of transport-related infrastructure services, e.g., ensuring there is competition in road, rail, maritime, and air transportation markets, to the processes that are used to ensure conformity with product standards. Governments are not necessarily aware of the impacts of prevailing policies on SCT investment incentives and operations. Moreover, existing trade agreements and similar forms of international cooperation usually are not designed with a view to minimize negative impacts of domestic policies on SCT. Nor are they designed to assist governments to put in place a policy environment that will support SCT specialization.

These considerations have implications for the design of trade agreements and international trade cooperation. Hoekman and Jackson (2013) and World Economic Forum (2013) advocate a "whole of the supply chain" approach to assessing and addressing the effects of regulatory policies on trade costs. The basic idea is that by organizing cooperation to focus on a bundle of policies that impact on SCT, governments will be able to better use the commitment technology offered by trade agreements to reduce domestic supply chain constraints as well as the barriers that are created by what trading partners do. A supply chain-informed approach can also be used as a mechanism to address the market-segmenting effects of differences in regulation, which is increasingly the main source of trade and investment barriers among high-income countries.

Hoekman (2013) suggests a number of elements for the design of a supply chain approach.

1. Select a number of supply chains or trade lanes. A first step in operationalizing the idea of a supply chain approach would be to select a half-dozen or so trade lanes/production networks that are important for a country and its major trading partners. Business needs to be an integral part of this process as governments generally will only have a very incomplete understanding of how supply chains operate. It will be important not to limit attention to only on existing trade and investment flows but to consider activities that have significant potential for expansion—e.g., by considering how regulatory policies impact on the ability of small and medium-sized enterprises (SMEs) to sell more internationally. Generally SMEs will be suppliers to lead firms, contract manufacturers or multinational service companies but they also increasingly can use the internet and business-to-business market platforms to sell their products internationally. Taking actions to facilitate greater international participation by SMEs is a priority for all governments, but often they may be unaware of how extant policies impact on the ability of SMEs to expand their international operations. An example is the cost hurdle imposed by security or privacy-motivated regulations such as a requirement to locate servers in the country of the consumer/client. Such regulations are much easier for a large firm to overcome than an SME.

2. Identify the cluster of policies that matter most. Once a set of supply chains/production networks has been selected, the first task would be to identify the most binding regulatory policy constraints that impact negatively on SCT. Here again the active involvement and participation by business is critical as such costs may not be evident given that they will often be reflected in delays and other sources of uncertainty that give rise to a need to hold excess inventory stocks and engage in other forms of costly "self-insurance." This process of "mapping" supply chain trade costs and inefficiencies to regulatory policies will require inputs from both business and other knowledge providers. Supply chain managers within firms may not understand or be interested in determining the contributions of various sources of costs and uncertainty and which specific policies have the greatest effects, implying a need for collaboration with researchers and analysts.

3. Agree on an action plan. Another essential task for supply chain councils is to discuss and agree on an action plan to address the sources of excessive SCT costs. Here again the public-private partnership nature of the endeavor is important. The participation of both the relevant regulatory bodies and those in government who are responsible for economic policy more generally is necessary to be able to decide what can be done to reduce regulatory compliance costs without detrimentally affecting the realization of the underlying regulatory objectives. At the same time active engagement by the business community can facilitate identification of approaches that lower compliance costs without putting into question the rationale for regulation. In practice it is likely that action agendas will require engagement of government officials, business, consumer groups and legislators.

4. Set performance indicators. Measuring and quantifying the "performance" of the supply chain networks that are the subject of deliberations in ways that can be monitored over time. The aim should not be to restrict attention to identifying the most binding constraints (sources of trade costs) but to set specific targets for improvement. What such key performance indicators may be will depend in part on the type of activities or products involved. Establishing numerical baselines will help both to motivate the need to pursue reforms and is a critical ingredient in determining whether progress is being made over time to reduce trade costs. One reason why metrics are critical is because of the scope for policies to substitute for each other—removing one source of redundant or duplicative regulatory cost may not have an effect if other policies continue to impose excess costs.

5. Monitoring, learning and accountability for results. A final element would be to ensure active monitoring and reporting on progress and results. This should be public (published) both to ensure transparency and to increase the incentives of those who are tasked with taking actions do so. This is a function that will depend importantly on having established a quantitative baseline and collecting the data that are required to determine if performance on the chosen metrics is being made. While the analysis of progress made (or not made) and reporting should be done by independent entities to ensure that conflicts of interest do not arise, business again has a critical role to play as often it will have the best access to the requisite data. If, for example, the performance indicators are centered on the time it takes for consignments to satisfy all border management processes, or the share of transactions that are physically inspected, or the variance in the average time that is required for regulatory approval to be obtained, data on the outcomes that are realized on these metrics will need to come from the business community.

Trade facilitation is necessary but not sufficient

There has been extensive debate in the WTO context regarding the need for and potential benefits of concluding an agreement on trade facilitation. It is very difficult to comprehend why some negotiators, including from countries such as India that have a high trade cost operating environment, oppose such an agreement given the importance of lowering trade costs to attract SCT investment and to capture the associated employment and income benefits. The extant research, and, more important, the experience of countries that used SCT to sustain high rates of economic growth suggests that investment of political capital and financial resources in trade facilitation will have a high rate of return. But whatever may emerge from the WTO process and the Bali Ministerial, it will only partially address the sources of trade costs that inhibit SCT. An approach that is broader and that focuses more centrally on the factors that impact on SCT is needed at the domestic, regional and multilateral level

References

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