



FUTURE OF CUSTOMS

Global Value Chains

(Item X (a) on the Agenda)

I. Introduction

1. The Virtual Working Group on the Future of Customs (VWG FC) had collected and submitted to the PTC in October 2015 all forward-looking topics that were felt would have an impact on Customs in the future (this list is contained in Annex II to doc. PC0422). Though the Global Value Chains (GVCs) was presented to the Policy Commission and the SAFE Working Group previously, it had not been discussed within the WCO committees at technical level therefore it was included in the list of topics.
2. This document is based largely on the results of various research papers produced by international organizations, academia, research institutes etc. It further endeavors to identify the direct links and implications of those findings on Customs business, more specifically on Customs procedures and trade facilitation. It further looks more particularly into inward/outward processing procedures and how related improved practices can support better connectedness to GVCs.

II. Global Value Chains (GVCs)

3. International production, trade and investments are increasingly organized within GVCs where the different stages of the production process are located across different countries. Globalization motivates companies to restructure their operations internationally through outsourcing and off-shoring of activities. The past decades have witnessed a strong trend towards the international dispersion of value chain activities such as design, production, marketing, distribution, etc.¹ Generally, multinational companies are those setting the rules of the game in GVCs, and govern a multitude of SME suppliers who are seen as those providing intermediate input and acting as sub-contractors several levels down from the ultimate buyer.

Supply Chain vs. Value Chain

4. The difference between a supply chain and a value chain is that a supply chain emphasizes the manufacturing and distribution-related steps, whereas a value chain

¹ « Global Value Chains », OECD web site: <http://www.oecd.org/sti/ind/global-value-chains.htm>

also includes the importance of other activities such as design and branding that add value to a product but do not necessarily reflect a physical transformation.²

Value Chain vs. Global Value Chain

5. The value chain describes the full range of activities that firms and workers do to bring a product/good or service from its conception to its end use and beyond. This includes activities such as design, production, marketing, distribution and support to the final consumer.
6. The difference between a value chain and a global value chain is that a value chain can be contained within a single geographic location or even a single firm, while a global value chain is divided among multiple firms and geographic spaces.

Backward and Forward GVC participation

7. The GVC participation index is composed of two components reflecting the upstream and downstream links in the chain. Basically, individual economies participate in global value chains by importing foreign inputs to produce the goods and services they export (**backward GVC participation**) and also by exporting domestically produced inputs to partners in charge of downstream production stages (**forward GVC participation**).

Trade in Value-Added (TiVA)

8. The flows of goods and services within these global production chains are not always reflected in conventional measures of international trade. According to the WTO, “attributing the entire commercial value of an exported good to the last link of the chain can lead to statistical bias and misunderstandings”.
9. The joint OECD – WTO Trade in Value-Added initiative (as part of the “Made in the world” initiative) was launched because of the need to revise statistical concepts and methods for measuring trade flows (national accounts, balance of payments, customs-based trade statistics etc.). It addresses this issue by considering the value added by each country in the production of goods and services that are consumed worldwide. TiVA indicators are designed to better inform policy makers by providing new insights into the commercial relations between nations.
10. The WTO has released statistical profiles on GVCs for 61 economies. These profiles, available on the WTO website³, bring together a set of indicators on trade taking place within GVCs. These profiles contained in the OECD-WTO TiVA database provide insights into the value-added content of exports, the interconnection between economies within GVCs and the role of the services industry in exports. They also include other indicators related to GVCs such as trade in intermediate goods, trade facilitation and foreign direct investment.

Mapping GVCs

11. Apart from macro-level analyses, there are also micro-level, product specific analyses aimed at mapping global value chains and value added across countries involved in the production of a specific product. For example, the OECD has carried out such mapping for a number of products and industries (agriculture and food products,

² Global Value Chains Initiative web site, Duke University, <https://globalvaluechains.org/concept-tools>

³ https://www.wto.org/english/res_e/statis_e/miwi_e/countryprofiles_e.htm

chemical products, motor vehicles, electronics, business and financial services).⁴ These analyses can also help Customs gain a better understanding of the new trading and production patterns and how it can improve its procedures to better support them.

III. Implications of GVCs for trade policy and trade agreements

12. The globalization of supply chains calls for a more coherent view of trade and trade-related policies. Namely, there is a view that around 80 percent of global trade is conducted through global value chain networks.
13. The fragmentation of production has created new opportunities for developing economies and for small and medium-sized firms to access global markets as components or services suppliers, without having to build the entire value chain of a product and, as already mentioned, SMEs are usually acting as subcontractors providing intermediate input. E-commerce is having an important role in the expansion of GVCs and in integrating SMEs into them. At the same time, GVCs place new demands on firms, in particular as regards the need for strong coordination and efficient links between production stages and across countries.
14. But the gains are even greater when more countries participate and markets are opened on a multilateral basis. GVCs strengthen the economic case for advancing negotiations at the multilateral level, as barriers between third countries upstream or downstream matter as much as barriers put in place by direct trade partners and are best addressed together.
15. While multilateral agreements are widely accepted as the best way forward, most of the liberalization outside of purely unilateral opening has occurred at the regional level in the past two decades. To promote the expansion of GVCs, regional trade agreements (RTAs) are more effective when their membership is consistent with regional production networks.⁵

IV. Implications of GVCs on Customs Procedures

16. Promoting further engagement in GVCs could possibly be achieved not only by implementing trade and investment policy reforms, but also by improving Customs procedures and logistics..

Customs procedures and trade facilitation

17. International rules, standards and regulations make GVC-related transactions easier. Foreign direct investment, which tends to be very sensitive to policy barriers and red tape, is a key vehicle of GVC participation.⁶
18. As goods now cross borders many times, first as inputs and then as final products, fast and efficient Customs procedures and logistics are essential to the smooth operation of supply chains. A country where inputs can be imported and exported within a quick and reliable time frame is a more attractive location for foreign

⁴ De Backer, K. and S. Miroudot (2013), "Mapping Global Value Chains", OECD Trade Policy Papers, No. 159, OECD Publishing. http://www.oecd-ilibrary.org/trade/mapping-global-value-chains_5k3v1trgnbr4-en

⁵ OECD, May 2013, "Trade Policy Implications of Global Value Chains": http://www.oecd.org/trade/benefitlib/Trade_Policy_Implications_May_2013.pdf

⁶ Kowalski, P. et al. (2015), "Participation of Developing Countries in Global Value Chains: Implications for Trade and Trade-Related Policies", OECD Trade Policy Papers, No. 179, OECD Publishing, Paris. http://www.oecd-ilibrary.org/trade/participation-of-developing-countries-in-global-value-chains_5js33lfw0xxn-en

firms seeking to outsource production stages. As such, trade facilitation measures are crucial to foster participation in global production networks and global markets.⁷

19. N. Humphries in his Analysis “Global value chains, border management Australian trade” argues that for Australian business to compete in the environment of GVCs where goods and services are increasingly produced “in the world”, the Australian Customs and Border Protection Service needs to, for example, develop an Authorized Economic Operator programme that separates high-volume low-risk trade from high-risk transactions.⁸
20. Other trade facilitation measures such as Single Window, separation of release from final determination, advance rulings, inward/outward processing procedures and others can also potentially have a positive impact on competitiveness in GVCs. Despite the fact that these measures have been implemented by Customs administrations across the world for decades now, they have also been incorporated in the WTO Trade Facilitation Agreement, which will become binding on WTO Members, once it comes into force.
21. Surveys performed among private sector representatives showed that especially for lead firms, Customs procedures were ranked highly as a particular obstacle to bringing developing country suppliers into their value chains, as well as standards compliance issues. Informal practices and payment requests were also cited as of particular concern in their relationships with suppliers.⁹

Processing trade

22. One particular lens through which a subset of global value chains can be looked at is the so-called processing trade. Processing trade - the process through which companies source intermediate inputs from various countries, assemble them in another for the final consumption in third markets - has been credited with a large role in the impressive export performance of for instance China over the last decade.¹⁰
23. In addition, the TiVA database information shows that, apart from China, other countries such as Ireland, Luxembourg, Malaysia, Singapore, Slovak Republic, Thailand, Tunisia, Taiwan, Viet Nam and others show a high percentage of share of GVC participation in total gross exports, in these cases with a high level of backward participation, which refers to import of foreign inputs to produce the goods and services they export.
24. Bearing this in mind, it is important to have a closer look at the existing standards and practices relating to Customs processing and examine areas requiring further improvements towards supporting greater engagement of economies in GVCs. These refer mainly to:

- I. **inward processing** procedures (temporarily imported goods for processing and further export benefiting from exemption from duties, levies or other checks); and

⁷ OECD, WTO, UNCTAD, “Implications of Global Value Chains for Trade, Investment, Development and Jobs”, 6 August 2013, Prepared for the G-20 Leaders Summit Saint Petersburg (Russian Federation) September 2013.

⁸ N. Humphries, September 2014, Lowy Institute for International Policy, Analysis “Global value chains, border management and Australian Trade”.

⁹ OECD, WTO and World Bank Group, “Global Value Chains: Challenges, Opportunities, and Implications for Policy”, Report prepared for submission to the G20 Trade Ministers Meeting Sydney, Australia, 19 July 2014: https://www.oecd.org/tad/gvc_report_g20_july_2014.pdf

¹⁰ L. Cernat and M. Pajot (2012), “Assembled in Europe – the role of processing trade in EU export performance”. http://trade.ec.europa.eu/doclib/docs/2012/october/tradoc_150006.pdf

- II. **outward processing** procedures (intermediate goods are temporarily exported for further processing, and the processed products are re-imported while benefitting from full or partial exemption from Customs duties and levies).

25. The advantages of having in place smooth procedures for inward/outward processing can have an important impact on facilitating access to GVCs and competitiveness of countries in that respect.
26. It should be noted that not all processing trade would necessarily be recorded under inward or outward processing procedures. In other words, for example, goods already imported for release into free circulation could be used for processing and export. In that case the exporter can benefit from duty drawback under specific conditions.
27. As already mentioned above, the TiVA database shows that processing trade in some countries represents more than 50% of total exports. In terms of related Trade Facilitation information, the TiVA database includes information only on the costs/time/number of documents required in average for export/import procedures per container. It does not collect information specifically relating to the inward/outward processing procedures, which makes it more difficult to determine how much have business-friendly/unfriendly processing procedures contributed to nations' inclusion in GVCs.
28. It is, nevertheless known that some countries' procedures for inward/outward processing are either over burdensome and complicating, making them less attractive for engagement in GVCs, or on the other hand are providing a high level of facilitation without the appropriate level of control.
29. In that respect, it is worthwhile having a closer look and examining the current situation regarding the available standards, instruments, tools and practices in processing procedures.

V. **WCO standards, instruments, tools and national practices**

30. WCO standards relating to inward/outward processing can be found in the Revised Kyoto Convention (RKC) in Specific Annex F on Processing, which consists of four chapters: Chapter 1 on inward processing, Chapter 2 on outward processing, Chapter 3 on drawback and Chapter 4 on processing of goods for home use.
31. Particularly important in the context of GVCs are Chapters 1 and 2 and their accompanying Guidelines, which provide more information on benefits, field of application, authorizations, control and audit, examination, identification measures etc. The Guidelines also include information on treatment of waste; processing procedure granted to goods that were already under another customs procedure (i.e. transit or were in a customs warehouse or free zone); avoiding to apply restrictions and prohibitions which normally apply to goods coming from a certain country; methods for identifying the quantities of imported goods in the compensating products; authorization; inward/outward processing records; retrospective authorization; general authorization; rate of yield; transfer of ownership of imported goods; processing operations to be carried out by a third person; procedures for monitoring discharge of imported goods; terminating procedure by placing imported goods or the compensating products under another customs procedure, etc.
32. However, to date, out of the 104 RKC Contracting Parties, only a limited number has acceded to the relevant chapters of Specific Annex F: 22 have signed up to the

Chapter 1 (out of which 5 with reservations) and 22 to Chapter 2 (out of which 3 with reservations).

33. The Revised Kyoto Convention Management Committee (RKC/MC) had at its meeting in October 2015 discussed inward processing under the request of Honduras. In conclusion, the RKC/MC encouraged other Contracting parties to further share their national experiences on the implementation of inward processing with the Secretariat.

VI. Potential way forward

34. Most of the RKC Guidelines relating to inward/outward processing were developed in 2000, which is far before the discussions on GVCs were launched at Customs level and the benefits of connecting to GVCs to national economies have been identified. In addition, there is very scarce information on national practices in this domain, which makes it more difficult for Members to identify the most adequate ones that would help them achieve the right balance between facilitation for firms involved in GVCs, and control of goods moved under processing procedures.
35. In that respect, collecting and exploring in more detail the current national practices that can provide Members with guidance on how to introduce or improve their support to the new trading patterns reflected in GVCs across many industrial sectors, while maintaining the adequate level of controls, would be an important benefit for the business, especially for SMEs. It would also ensure compliance of companies and secure the appropriate level of revenue collection.
36. This is all the more relevant, bearing in mind that the WTO TFA under its Article 9.2 includes mandatory provisions on inward and outward processing. As is the case with other TFA provisions, the Agreement provides only a framework, while specific guidance is required to support Members in implementing these provisions.

VII. Actions required from the PTC

37. The PTC is invited to :
- Discuss Global Value Chains and their implications on Customs business today and in the future;
 - Explore how Customs can improve the competitiveness of their countries in terms of supporting connectedness to GVCs;
 - Share national practices on relevant Customs procedures, in particular inward/outward processing practices;
 - Suggest the way forward, including:
 - Advising on the benefits of collecting and further exploring Members' practices on inward/outward processing procedures;
 - Recommending any development/update of WCO tools, such as the RKC Guidelines, to support Members in improving their competitiveness for connecting to GVCs and for fully complying with the TFA.
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