



Brussels, 18 September 2017.

UPDATE AND REPORTS

- Research on Global Value Chains -

(Item VIII. (i) on the Agenda)

Background

1. At its face-to-face meeting in July 2015, the Virtual Working Group on the Future of Customs discussed Global Value Chains (GVCs) as one of the emerging fields to be considered by the global Customs community. The meeting specifically touched upon facilitating GVCs and policy implications for Customs.
2. At the October 2016 PTC meeting, the Secretariat presented its initial research on GVCs (doc. PC0455) which included a definition, the difference between GVCs and global supply chains, information on the WCO/OECD Trade in Added Value (TiVA) database and GVC mapping, and how Customs can help improve connectedness to GVCs, especially through enhanced trade facilitation. The topic generated comprehensive discussions and inputs from Members, especially on the relevance of efficient inward and outward processing procedures for GVCs.
3. In April 2017, the PTC approved a Handbook on Inward and Outward Processing Procedures, as a means of raising awareness in the Membership and the private sector of the relevance of these procedures for improving connectedness to GVCs. In addition, the Secretariat made another presentation which was focused on implications of GVCs on a wide range of issues such as trade facilitation, trade agreements, transfer pricing and rules of origin.

Research Essay on GVCs

4. As a continuation of the work on GVCs, a research essay (Annex to this document) was developed based on the key points presented at the April 2017 PTC sessions.
5. The paper looks into the GVC concept, WCO's work on GVCs to date and puts forward some considerations for the future.

- 6. This research essay is not intended to be a conclusion on the topic and Customs involvement in that respect, but rather an interim point of view to be further expanded in the future, taking into consideration Members' priorities surrounding this area.

Action required from the PTC

- 7. The PTC is invited to take note of the research essay carried out by the Secretariat on Global Value Chains and of the considerations put forward for the future.

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Research Essay on

**Participation in the Global Value Chains:
Role of Customs and WCO's Activities to date**

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Participation in the Global Value Chains: Role of Customs and WCO's Activities to date

Section I

Introduction

Global Value Chains (GVCs) have become a dominant feature of world economy, driven largely by advances in transport and information technologies, business innovation and greater trade and investment openness on the part of governments. A GVC includes a full range of activities that firms undertake to bring a good or service from its inception to its end use by consumers (Kommerskollegium 2013). (All reference texts can be found at the end of this document). These activities include research and product development, component manufacturing, assembly or production, distribution and marketing and post sales services (World Free Zones Organization 2017). Most goods and services are produced in several countries and integration of the production phases is becoming more prominent.

With the increasing trend of integration of goods and services, many developing countries have emerged as key players in international trade, rendering developing countries a heterogeneous group of economies (Kommerskollegium 2013). Accordingly, the directions of both trade and investment have started moving from North to South and from West to East at an accelerating pace.

This essay attempts to discuss participation of mostly developing countries in GVCs with examples, their challenges and existing and emerging roles and responsibilities of Customs administrations around the world, along with that of the World Customs Organization (WCO). Finally, it puts forward a few recommendations for the future to help develop capacity of its Member administrations in facilitating GVCs.

Section II

Global Value Chains: Concepts

The term 'value chain' usually refers to various stages in which value is added to a product or service during pre-production, production and post-production phases. A value chain is 'global' when some of these stages are carried out in more than one country, most notably when these processes are fragmented and dispersed across a number of countries (World Bank 2016). While outsourcing in the past tended to remain geographically proximate, the key trend in recent

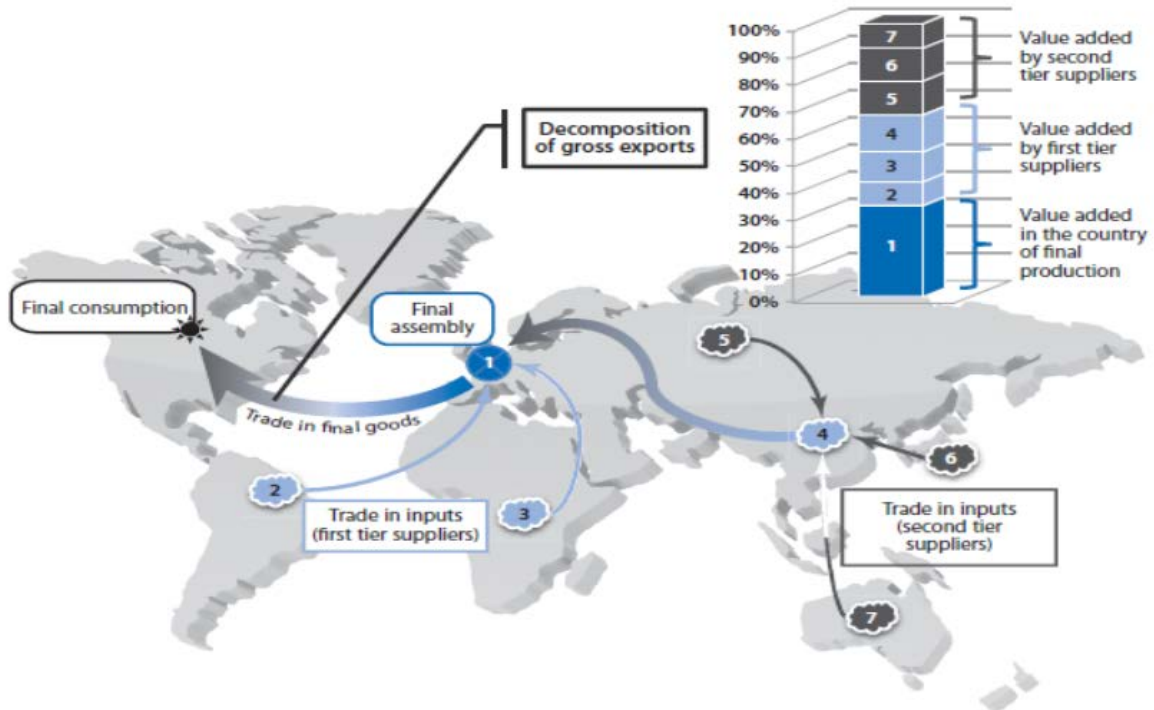
years has been offshoring of outsourced processes. According to Baldwin (2012), this 'unbundling' of production was made possible due to the following factors:

- Improved shipping technology that reduced the cost and time of moving components around the world;
- Global trade liberalization that also reduced substantially the cost of moving parts;
- Global capital market liberalization that facilitated FDI flows from transnational corporations; and
- Revolutionary changes in information and communication technology (ICT) that substantially reduced the costs and challenges of coordinating and monitoring distant activities.

World Bank (2016) defines GVCs from three different perspectives: sectoral, functional and geographical. From a sectoral context, traditional description of a GVC tends to explain vertically segmented production networks, where different tasks are taken place in different countries. According to some analyses (Baldwin and Venables 2013), this vertical specialization may result in networks of **spiders** where different parts and intermediate goods are produced in different locations and finally re-assembled in one; or **snakes** where each stage of value addition takes place in a different location, or combination of the two. From a functional context, GVCs are importation for export, meaning imported intermediate goods or parts are embodied in a product which is finally exported. However, some experts argue that most GVCs are not truly global, but rather regional in nature. Although discussions on GVCs often highlight globalization and multilateralism, integrating at the regional level is most critical.

Figure 1 shows a simple definition of a GVC where raw materials and intermediate goods are collected from countries 2, 3, 4, 5, 6 and 7 in order to assemble in country 1 before exporting to consumers in other countries.

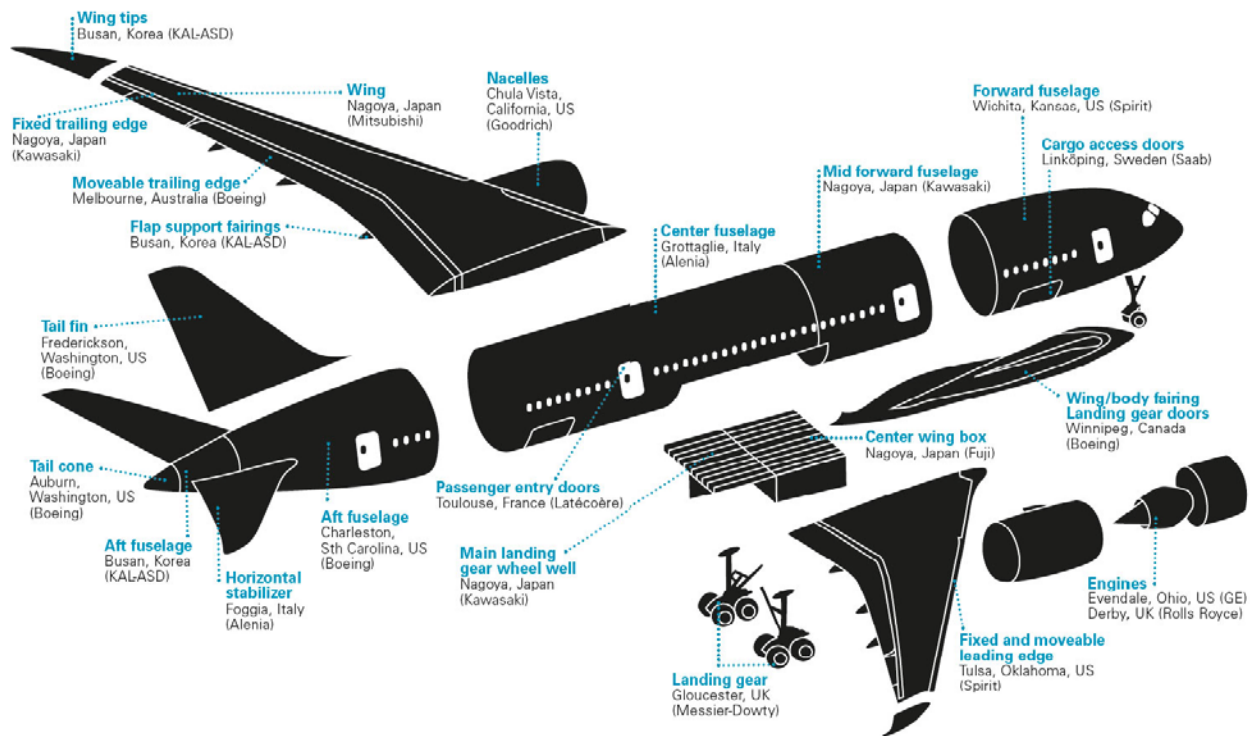
Figure 1: a simple definition of a GVC



Source: OECD

A classic example of a Boeing Dreamliner would explain this further. The Boeing 787 Dreamliner is assembled in the United States from components built around the world. The centre fuselage is from Italy, the mid-forward fuselage is from Japan, the Rolls Royce engines are from the UK and a vital wing component - the moveable trailing edge - is designed and produced in Melbourne at Boeing Aerostructures Australia. Bringing all these parts together to build a Dreamliner is an example of a GVC in action.

Figure 2: Boeing Dreamliner, a classic example of GVCs in action



Section III

GVCs: WCO Activities to date

One of the first discussions on GVCs in the World Customs Organization was held in 2014 at the 13th Meeting of the SAFE Working Group. In that Meeting, the Private Sector Consultative Group (PSCG) used five examples of GVCs from the consumer electronics, aviation, automotive, retail and food industries in order to explain the complexity and diversity of the modern businesses and value chains, to raise Customs' awareness of the varying degrees of business criticality through the value chain and also to identify common and unique needs of the government and the private sector.

At the 43rd Session (October 2016) of the Technical Committee on Customs Valuation (TCCV), an Information Document about Customs Valuation in GVCs was presented in reference to a question posed by Uruguay regarding determination of value for GVCs influenced by transfer pricing in a previous meeting. The TCCV accepted the question and examined it from its 36th to 41st Sessions. When dealing with transactions related to GVCs, TCCV examined valuation issues related to a) sale of export, b) conditions of Article 1 of the WTO Valuation Agreement, c) related party transactions, and d) Article 8 on adjustments. Finally, TCCV agreed that the

provisions of the WTO Valuation Agreement are adequate to determine the Customs value of either intermediate inputs or final products and it was not necessary to issue an instrument to that effect.

Furthermore, during its face-to-face meeting on 7 July 2015, the Virtual Working Group on the Future of Customs discussed GVCs as one of the emerging fields to be considered for global Customs community. The meeting specifically touched upon facilitating GVCs and policy implications for Customs. In the October 2016 PTC, the Secretariat presented its initial research on GVCs which included definition, difference between GVCs and global supply chains, WCO/OECD TiVA database, GVC mapping and its relevance to Customs, trade facilitation measures for improving connectedness to GVCs (from procedures point of view, e.g. inward and outward processing). The topic generated comprehensive discussions and inputs from Members, some of them offered to provide more information and contribution to the work ahead. In the April 2017 session of the PTC, the Secretariat made another presentation which was focused on implications of GVCs on a wide range of issues; such as, trade facilitation, trade agreements, transfer pricing, and rules of origin.

Section IV

WCO Handbook on Inward and Outward Processing Procedures

Efficient inward and outward processing procedures can support Members in better connecting to Global Value Chains, as was discussed at the October 2016 PTC. Furthermore, these procedures are mandatory under the WTO Trade Facilitation Agreement (Article 10.9) which entered into force in February 2017.

In December 2016, the Secretariat carried out a survey on inward and outward processing procedures where 80 Members responded to questions relating to, among others, legislation, procedures, IT support and governance.

The Handbook on Inward and Outward Processing Procedures was developed based on the results of the survey and the additional information kindly provided by Members, including pieces of legislation, authorization forms, guidelines etc.

The Handbook builds on the already substantial Specific Annex F to Revised Kyoto Convention Standards and Guidelines (World Customs Organization 2006) (Chapters 1 and 2 on inward and outward processing) and is intended to provide WCO Members with the different legislative and procedural examples for inward and outward processing, IT solutions and governance solutions used by the WCO Members. The objective of the Handbook is to encourage and support

Members and the private sector to make better use of the best practices of inward and outward processing procedures in different parts of the world. This will increase economic competitiveness and trade facilitation in particular, as well as connecting Members' economies to GVCs.

The survey showed that almost all the Member respondents have in place required legislative provisions on inward and outward processing procedures although some of the administrations have different names like duty relief and duty drawback programme or rebate due to processing of goods etc., but are mostly based on the same principles of import/export for manufacturing, processing or repair and sub-subsequent export/import with full or partial relief from duties and taxes. It was also reported that specially for the inward processing, Members implement different procedures for processing of goods for home use, processing in free zones, in bonded areas, in free ports, industrial warehouse, duty-free replenishments, and within export-oriented company-premises. In the survey, 66 % of the respondents reported that they have drawback procedures in place while some others depend on duty-free imports of raw materials. According to the survey, most Members (78 %) require bank guarantees (individual or comprehensive) for both inward and outward processing.

The authorization for inward and outward processing may be obtained from a competent authority and issued in a certain period of time after submission of request. In most cases, the competent authority is Customs, while in some countries some other regulatory authorities such as the Ministry of Trade, the Ministry of Finance, the Ministry of Industry, Ministry of Investments and Development, Ministry of Agriculture, Ministry of Energy and Mining are empowered to approve such authorizations based on economic policy. However, Customs remains the main department that ensures that all the conditions required for the procedure are fulfilled. The audit procedures are commonly carried out by Customs (i.e. post-clearance audit). According to the survey, the other authorities carrying out the audit include the National Audit Authority, the General Administration for Foreign Trade Audit, the Tax Administration, as well as other authorities such as the National Technological Lab.

Section V

Some considerations for the future

Tariffs and para-tariffs

Tariffs on imported goods used in the production of exported goods increase the cost of production. Tariffs on intermediate goods become a tax on production (Kommerskollegium

2013). If production consists of multiple levels of components in different parts of the world and in all partner countries the raw materials and intermediate goods are taxed, the production faces multiple-taxation and the final product loses its competitive advantage against similar products manufactured elsewhere. Some countries often reimburse the duties paid at the time of importation in the form of credit, drawback, relief and adjustment; however, the documentation and audit processes to enjoy the facilities are often complicated (OECD 2012). On the other hand, there are few countries that impose duties on exports on top of tax on value added services at the different levels of production. In most cases this multiple taxation is justified by mentioning that tax credits are allowed at each phase and finally the tax is on the consumer, not on the production process. However, there is no denying of the fact that the value added taxes at each value addition phase and export tax, no matter how low it is, discourage GVCs. Moreover, reducing tariffs in developed countries may lead to preference erosion for the benefits granted to developing countries through, for example, the EU Generalized Scheme of Preference (GSP) (Kommerskollegium 2013). Many developing countries undertook few specialized schemes with a view to neutralizing the effects of multiple-taxation, such as:

- Duty-free importation of raw materials and intermediate goods;
- Duty drawback;
- Tax credit;
- Bonded warehouse facilities, special economic zones, specialized customs zones;
- Export processing zones.

Customs procedures

In many countries Customs procedures are seen as hindrances to efficient trade although facilitating trade is one of the foremost responsibilities of Customs administrations around the globe. When it comes to intermediate goods crossing borders multiple times within a single production chain, procedures get even more complicated. In-time production and delivery is important for any production and supply chain. For GVCs where intermediate goods are manufactured in one place and assembled in another for a final production, the timeliness is most important. If any part of the production suffers delay in any of the partner countries, the whole GVC suffers which creates comparative disadvantage for the product.

The use of modern technology in Customs clearance, introduction of Authorized Economic Operators (AEOs) program, risk management and post clearance audit mechanisms, advance rulings and coordination among border agencies are examples of facilitation measures that would enable a faster, cheaper and more predictable movement of goods. After the WTO

Agreement on Trade Facilitation came into force, most countries are committed to improve their border procedures which would increase developing countries' ability to participate in the GVCs. Most countries allow inward and outward processing procedures to facilitate participation in GVCs. In most cases, imports of raw materials are allowed duty-free into the country and using low-cost domestic labor in the country intermediate goods are produced and exported to the country of assembling. Similarly, for outward processing, materials sent to another country and processed there for further processing or assembling. However, these schemes are often very complex and therefore resource consuming which makes them unpopular for traders. The WCO Handbook was developed to promote the use of these procedures that can help Members better connect to GVCs.

Rules of Origin

Developing countries are, in some cases, given preferential market access for exports through reduced tariffs (for example, the EU's Generalized System Preference (GSP) program, the United States' African Growth and Opportunity Act (AGOA) program). Though the preferential agreements seem beneficial for developing countries, in practice, most of them fail to get benefitted failing to conform to strict rules of origin attached to the agreements. If rules of origin are not designed in line with the member countries' ability to follow, they might discourage participation in GVCs and reduce positive effects of trade agreements.

Flexible cumulation rules

The negative effects of strict rules of origin may be minimized with introduction of flexible cumulation rules among member countries of the regional trade organization or among GVC partner countries.

Higher *de minimis* thresholds

High tariff rates are seen as one of the foremost hindrances for countries' participation in the GVCs. For some other government policies, sometimes many countries cannot reduce or eliminate duties or taxes on products of different sectors. In such cases, higher *de minimis* threshold may be one of the options. However, *de minimis* threshold would not help imports for large scale production.

Special Incentives (i.e. cash incentives)

Some countries have special incentive schemes for exports and export oriented industries. Similar schemes may be offered for intermediate products to encourage participation in GVCs.

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