ECONOMIC AND SOCIAL COMMISSION FOR WESTERN ASIA (ESCWA)

ECONOMIC TRANSFORMATION THROUGH CONNECTIVITY TO GVCS IN THE ARAB REGION: EVIDENCE FROM THE TIVA DATABASE

Prepared by

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United Nations
Beirut, 2017

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I. Introduction

Trade and production patterns in the world are increasingly governed by global value chains (GVCs). The emergence and spread of GVCs is an important driver of increased efficiency and competitiveness by allowing firms to reap the benefits of greater fragmentation of international production. Although GVCs are often coordinated by multinational enterprises (MNEs), which dominate the cross-border trade of intermediate and final goods, domestic suppliers, notably small and medium-size enterprises, play a growing role in the production of goods and services that ultimately reach foreign consumers. As a greater share of income is generated by GVC integration in domestic economies, greater shares of total employment are sustained by such activities around the world. Also, the fact GVC integration often requires technological progress, infrastructure investment and upgrading, improvements in regulatory framework, and liberalization of trade and investment regimes, greater involvement in GVCs is likely to be associated with sizable and durable gains in productivity growth.

GVC integration by focusing exclusively on trade and investment policies does not necessarily result in net benefits to an economy. It may even generate adverse effects (Kaplinsky, 2005; Lee et al. 2011). GVC integration needs to be mainstreamed into development plans to ensure linkages with the local economy and to build capabilities to better capture opportunities. This should be done in a manner that leads to high quality jobs and durable and sustainable gains in the standards of living.

The challenge for developing countries is not limited to integrating into GVCs. Upgrading in the value chain is also an important aspect. Developing countries tend to engage in low value segments, which range from assembly activities in manufacturing to primary agricultural products and commodities with little or no processing.

The level of GVC engagement across different countries and country groups over time show some variation while data generally confirms the increasing importance GVCs. Greater GVC integration has led to substantial gains for most economies, albeit to varying degrees. Emerging Asian economies appear to have benefited greatly from the great internationalization of production.

II. The GVCs, trade, and trade policy: evidence from the OECD Countries

The level of GVC engagement across different countries and country groups over time show some variation while data generally confirm the increasing importance GVCs. Greater GVC integration has led to substantial gains for most economies, albeit to varying degrees. Emerging Asian economies appear to have benefited greatly from the great internationalization of production.

Figure 1. Value added created/captured by selected economies in GVCs of manufactured goods and market services, 1995 and 2011 (USD billion)

Source: OECD-WTO TiVA database, October 2015 release.
The evolution of the distribution of value added created and captured from the participation of countries in global manufacturing and services reflects this pattern. Timmer et al. (2012) introduced the concept of GVC income, which includes the value added by a country in the production of final goods in both manufacturing and non-manufacturing, and the production for both foreign and domestic demand. They focus primarily on manufactures as the production of these goods is highly fragmented and internationally contestable. The GVC income generated in manufacturing industries has grown relatively modestly in advanced economies between 1995 and 2011 while China has recorded a drastic increase. Japan on the other hand has witnessed practically no growth in GVC manufacturing income (Figure 1). TiVA database also allows the extension of the GVC income measure to services as it provides reliable data on services. As opposed to manufacturing industries, advanced economies, with the exception of Japan, have seen their GVC incomes from market services more than doubled between 1995 and 2011. China’s GVC income growth between 1995 and 2011 was not limited to manufacturing; its GVC income from market has outstripped that from manufacturing industries.

Another measure that is worth looking into is domestic value added embodied in foreign final demand, also referred to as “exports of value added”. OECD countries have recorded a more than a three-fold increase in nominal terms in this measure between 1995 and 2011. More vibrant Asian economies have seen much larger increases: over a 13-fold increase for China and an 11-fold increase for Viet Nam. The two Arab countries included in the TiVA database have had diverging performances in terms of the exports of value added. Tunisia, despite starting from a similar level of the income derived from GVCs in 1995 to Viet Nam, has experienced a much limited increase of around 150%. Saudi Arabia on the other hand had managed to boost exports of value added by over 500% over the same period but the sharp increase has largely come from the activities of extractive industries. Nevertheless, available data suggest that Arab countries account for a rather a limited share of world GVC income, underlining the need for them to integrate into or to upgrade within GVCs.

Available data indicate that the income derived from trade flows within GVCs has increasingly been redistributed towards emerging economies, whose share in world exports of value added has increased from 21% in 1995 to 34% in 2009 (update Ash, 2013). Consistent with the overall pattern, Tunisia and Saudi Arabia have also seen emerging economies gaining prominence as destinations of value added. For instance, the EU accounted for 75% of Tunisia’s exports of value added in 1995, while this figure dropped to around 65% in 2011. Saudi Arabia also has had a similar experience, achieving greater exports of value added to emerging economies at the expense of developed economies. The share of the combined exports of value added of Saudi Arabia to EU and NAFTA declined from 40% in 1995 to 28% in 2011, with relatively similar drops in the share of the blocs (calculations based on OECD, 2015 [tiva database]).

The sectoral composition of the exports of value added has shown some variation in Saudi Arabia, but only little in Tunisia between 1995 and 2011. The mining and quarrying sector is the only notable exception and has recorded a relatively large increase in its share, from 6% in 1995 to 15% in 2011. Similarly, Saudi Arabia has seen the share of the mining and quarrying shoot up by 10 percentage points to 28% in 2011, from 18% in 1995. This increase has occurred fully at the expense of the manufacturing sector, the share of which dropped by 10 percentage points to 20% in 2011. This pattern in part mirrors other major regional blocs. For instance, ASEAN, the EU and NAFTA all have experienced a decline in the share of manufacturing and an increase in the share of mining and quarrying over the same period, albeit to a lesser extent than Saudi Arabia. The share of business services has been not only maintained in the EU and NAFTA but also increased slightly (calculations based on OECD, 2015 [tiva database]).

Trends in the evolution of participation ratios however appear to be more similar across countries. In terms of backward participation, since 1995, most countries and country groups included in the TiVA database have seen a steady increase in the share foreign value added in gross exports. ASEAN is a notable example, where backward participation levels have been declining as a bloc but for individual countries the picture is mixed. Viet Nam, for example, has recorded a marked increase in its backward participation.

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1 This GVC income measure covers value added in both manufacturing and the rest of the economy and both domestic and foreign demand.
Forward participation levels, as measured by the share of domestic value added in exports of intermediate products as a share of total gross exports, have been relatively stable across time for most countries and there is no discernible trend for most countries and country groups considered (Figure 5).

The two Arab countries, namely Saudi Arabia and Tunisia, for which data are available, exhibit differing degrees of backward participation in GVCs. Backward linkages, as measured by the share of foreign value added in gross exports, are comparable in Tunisia to Poland and the ASEAN and EU averages. Poland and Vietnam appear to have experienced sharper strengthening in backward linkages compared to Tunisia over the period 1995-2011. Tunisian manufacturing is among the sectors that exhibit very strong backward linkages. The business services sector, while showing weak backward linkages in the past, have seen a marked improvement in 2011.

Due in large part to its reliance on oil, in Saudi Arabia, on the other hand, backward linkages are very weak in the economy as a whole and across a great number of sectors. The gap vis-à-vis the comparator countries and regions are particularly wide in mining and manufacturing, mainly reflecting the structure of chemicals and non-metallic mineral products production in Saudi Arabia.

Bamber et al. (2014) point out that extractive industries are relatively new to specialization and outsourcing. Leads firms that have ownership or extraction rights drive the development of supply chains. Low prices often reinforce the tendency of lead firms to contract few bigger suppliers, which can satisfy their demanding requirements. Also, some global firms that are able to operate in several regions simultaneously increasingly undertake some of the functions of lead firms in the oil and gas industries. However, developing countries find it to difficult participate in the supply chains of extractive industries, which are characterized by high capital, knowledge and technology intensity and have only limited linkages with the domestic economy. Morris et al. (2012) indicate that domestic firms are mostly involved in site-specific and support services to meet local content requirement rather than on the basis of comparative advantage.

Tunisia has relatively weaker forward linkages with the rest of the world, as measured by value added in exports of intermediate products as a share of total gross exports, compared to the OECD, NAFTA and the EU. Tunisian manufacturing, and, to some extent construction, sectors appear to have a larger gap vis-à-vis better performing countries and regions.

Saudi Arabia has strong forward linkages with the world economy, owing mostly to the dominance of extractive industries in its economy. This is reflected in the rather strong forward linkages of the mining and quarrying, and manufacturing sectors. In fact, with the exception of the community, social and personal services sector, Saudi Arabia appears to have relatively strong linkages with the rest of the world.
Figure 2. Re-exported intermediates as a percentage of intermediate imports, 1995 and 2011

Source: OECD-WTO TiVA database, October 2015 release.
Figure 3. Foreign dependency of final demand and production, 2011

Source: OECD-WTO TiVA database, October 2015 release

Figure 4. Foreign value added content of exports by country, 1995 and 2011

Source: OECD-WTO TiVA database, October 2015 release.
III. Arab countries’ GVC engagement performance

The Trade in Value-Added (TiVA) database of the OECD, developed jointly with World Trade Organization (WTO), allows a more accurate and detailed picture of countries’ integration into global and regional production networks by providing estimates of trade flows in value-added terms. As opposed to trade flows in gross terms, trade in value added better captures the role of international trade in income and output creation in a world in which products and components cross borders multiple times and the activities of firms take place in more and more specialized domains, including at the business function or even task level.

Following the approach taken by Hummels et al. (2001) and further developed by Koopman et al. (2011), a country’s GVC integration can be gauged by assessing the extent of how the country is involved in the international production process. Value chain participation is measured in terms of value added in exports looking backwards and forward from a reference country. Backward participation relates to the use of foreign inputs in producing exports in the reference country. Forward participation, on the other hand, captures the use of domestic intermediates in producing exports in the destination country. The TiVA database provides a decomposition of gross exports into foreign and domestic value added and allows the calculation of backward and forward participation measures at a more disaggregated level.

Backward and forward participation measures capture distinct forms of value chain engagement. A county that is primarily involved in importing intermediate goods and components and assembling products into final goods and exporting those to third countries would show strong backward but weak forward participation. By contrast, countries that mainly provide parts and components to assemblers would score high in forward participation but not in backward participation. While countries in general are engaged in both types of GVC participation, they tend to have one type of participation more dominant than the other, suggesting that policy and structural determinants of GVC integration is likely to depend on the nature of GVC participation.

A number of factors are theoretically and empirically associated with the extent to which a country is integrated into GVCs. Kowalski et al. (2015) consider several of those policy and structural elements specifically. Market size is an important determinant of GVC trade, as in the case of gross trade flows and suggested by the gravity theory of trade. A larger domestic market size allows countries to source relatively larger share of inputs domestically to use in producing their exports. A larger pool of domestic inputs would also tend to increase the share of domestic inputs in exports to be used in producing the exports of partner countries. The distance to GVC activity and final demand are other key determinants of GVC participation. GVC manufacturing hubs tend to be clustered around few locations, notably including China, Germany and the US, and proximity to the closest hub is positively associated with stronger forward linkages. In the same vein, the closer economies are to final demand, the stronger forward participation is. In addition, the level of development is closely linked to the structure of an economy and has implications for GVC participation. As an economy progresses along a development path, the nature and extent of a country’s GVC participation evolves. For instance, at earlier stages of development, specialization in primary products, which tend to be used as imported inputs in production of more sophisticated products in partner countries, dominate production and trade flows, boosting forward linkages. As the country further industrializes, it can engage in assembly activities driven by efficiency advantages. The emergence of a competitive service sector and capacity to engage in more innovative activities at later stages of industrialization leads to stronger forward linkages. Higher income per capita is also another driver of greater GVC participation. As income in per capita terms increases, countries tend to sell and buy more intermediate goods.

Considering both policy and structural factors exert significant influence on the GVC participation of countries, a more accurate way of assessing of GVC integration performance of a country entails looking at how such factors contribute to the level of participation. Policy and non-policy characteristics of a country predict a certain level of GVC participation and the actual level of GVC participation can be compared against this benchmark to identify weak performing countries. For instance, a lower GVC participation level of a country with a relatively large economy does not necessarily mean worse GVC integration performance. Kowalski et al. (2015) take this line of approach and decompose the contributions of
structural, geographical and policy factors to GVC participation. In doing so, it is possible to identify the policy-induced constraints to greater GVC integration.

Figure 5. GVC participation index, 2011

Source OECD-WTO TiVA database, October 2015 release.

Note: The GVC participation index is calculated as the sum of the backward participation index, as measured by the share of imported inputs in the overall exports of a country, and the forward VS1 (i.e. the share of exported goods and services used as imported inputs to produce other economies’ exports) measures.

Kowalski et al. (2015) find that non-policy factors and the constant term explain most of the backward and forward participation levels, as measured by the share of foreign value added in gross exports and the share domestic value added embodied intermediate exports used in producing exports in the partner country, respectively. Based on OECD-WTO TiVA data, they estimate that the contribution of trade policy and investment openness to backward participation ranges from a few to over 20 percentage points across countries included in the analysis, in effect doubling the level of backward participation that would be observed in the absence of any contribution from these factors. For instance, the level of backward participation for Hong Kong is almost three times the level predicted by its non-policy factors, mainly on account of its high degree of investment openness. Similarly, in some countries, notably including Belgium, the Czech Republic, Iceland, Ireland, Luxemburg and Singapore, trade and investment openness provide a significant boost to backward participation. Saudi Arabia, the only country included in the analysis from the Arab region, shows the lowest level of backward participation. While, based on non-policy factors, Saudi Arabia would have been expected to have similar backward participation levels as Australia, Hong Kong, India, and the United Kingdom, the actual backward participation levels vary widely among these countries. In addition to practically no positive contribution from trade and investment openness, the backward participation ratio in Saudi Arabia is pushed to a very low level by the factors that are not controlled for in the analysis, the residual. In terms of the forward participation ratio, Saudi Arabia is among the highest ranked, coming behind only Norway and Russia.

These results are relatively robust. Kowalski et al. (2015) replicate the exercise of estimating the determinants of GVC participation using the Eora MRIO database by Lenzen et al. (2013). As opposed to the TiVA database, the Eora MRIO database covers a much larger number of countries over a longer time.
period: 187 countries over the period 1990-2011\(^2\). Also, the estimation results for a few Arab countries are reported, making it possible to assess their GVC participation performance. As in the case of estimations with the OECD-WTO database, most of the backward and forward participation rates are explained by non-policy factors and the constant term in the regressions. Saudi Arabia no longer appears among the countries with lowest backward participation ratios and it has the highest forward participation ratio among the Arab countries. Egypt is the country with the lowest backward and forward participation ratios among Arab countries included in the analysis. Although, based solely on the part of participation rates explained by structural factors, Egypt would be ranked fairly highly, trade policy and other factors not included in the analysis detract from its backward and forward integration levels that would otherwise materialize. Jordan has the highest backward participation ratio in the Arab region, owing mainly to its investment openness.

\(^2\) Kowalski et al. (2015) find that the Eora MRIO database does a satisfactory job of capturing GVC participation at the aggregate level and allow assessing the determinants of GVC participation at different economic development levels. The OECD-WTO database is however preferred on the grounds that it provides more consistent information both at the aggregate and sector levels.
Figure 6. RCA based on gross exports and value-added exports, Tunisia and Saudi Arabia, 2011
IV. Policies that facilitate participation in GVCs

The emergence and expansion of GVCs depend crucially on trade and co-ordination costs. In this regard, declining transportation and communication costs have allowed firms to restructure their operations internationally across different sites and along different production stages. More reliable and cost-effective ICT and transportation services make international production sharing possible, where technological innovations such as internet and air travel make it easier for firms to co-ordinate their activities, and lower transportation costs make spreading production across multiple sites economically viable.

More generally, as parts and components cross borders multiple times along a value chain, all trade costs, not just tariffs, are amplified. Trade costs are cumulative as parts and components cross borders multiple times and apply not just to value added at each stage of the entire production process but to the total value of intermediate goods. Blanchard (2013) points out that further fragmentation of GVC processes is in fact an important factor that raises the effective rate of protection even if trade costs remain unchanged. Accordingly, trade costs constitute an even bigger barrier to GVC participation if specialization patterns are evolving towards more fragmentation of production processes in GVCs.

Trade policy

Tariffs and other unduly restrictive non-tariff measures constitute an important barrier not only to foreign suppliers and international investors but also to domestic producers, which see that their competitiveness is undermined by higher input costs and constrained supply chains. Successive waves of trade liberalization have dramatically reduced tariff barriers but the incidence of non-tariff measures remain pervasive and even low levels of tariff protection add up to steep rates by the time final goods reach their ultimate consumers. In fact, Yi (2001) derives the magnifying effects of tariff in a vertically specialized production network theoretically. Rouzet and Miroudot (2013) assess empirically such effects using OECD Inter-Country Input-Output model. The issue is particularly severe for downstream firms that pay tariffs on their imported inputs and full value of their exports. Compounding effects are larger when the share of foreign content is higher. The effective burden of tariffs on exporters is better captured by tariffs on the domestic value added of exports and tend to be significantly higher than effective tariff barriers on gross exports (OECD, 2013 [oecd-wto report]). In addition, tariff peaks and escalation pose problems even for sectors in which domestic content is high. For instance, the agriculture sector continues to face relatively high tariff rates. High effective tariff rates weigh on demand, and in turn production and investment at all stages of the GVC.

Regional trade agreements could facilitate GVC engagement. In fact, deep integration measures that go beyond traditional trade policy are increasing being incorporated into FTAs and bilateral investments treaties, as well unilateral domestic reforms in some developing economies. Theoretically, the depth of PTAs shapes and is determined by the extent of trade in parts and components. That is, greater trade along the value chain is associated with deeper trade agreements among PTA members and deeper PTAs lead to larger increases in trade among PTA members and may even stimulate the creation of production networks among potential members of a supply chain. Deep PTAs could become an important vehicle for narrowing gaps in the business laws and regulations of participating countries, providing an enabling environment for greater production sharing. WTO (2011) catalogues deep integration provisions in several disciplines, including investment, intellectual property rights, and completion policy, in 96 FTA that cover over 90% of world trade. The econometric analysis based on this database confirm theoretical predictions.

Based on the same data, Orefice and Rocha (2014) undertake an empirical analysis of the two-way relationship between deep integration and trade within production networks, estimating that signing a deep integration agreement increases production networks trade between member countries by almost 35 percentage points. Also after controlling for other determinants of engaging in a preferential trade agreement, a ten per cent increase in the share of production network trade over total trade increases the depth of an agreement by approximately 6 percentage points. Also the probability of signing a deep agreement is higher for North-South country pairs and Asian countries.
**Infrastructure**

Access to quality infrastructure at a reasonable cost is vital for becoming competitive and attracting foreign firms to outsource parts of their production processes in an economy, facilitating economies’ participation in GVCs. If existing infrastructure does not allow firms to produce their outputs competitively, to import inputs and to export their products on a timely and reliable basis, participation in GVCs and engage international production sharing.

**Transport and logistics**

Efficient and high quality transport, logistics, finance, communication and professional services are indispensable to GVCs. In fact, services play a larger role than gross trade statistics suggest.

Integration into global production networks require efficient transport and logistics services, as the coordination of activities along the network and movement of product depend crucially on such services and factors. In fact, trade facility measures such as high quality transport and logistics services, efficient border management procedures and regulatory requirement play a larger role in the internationalization production than traditional trade policy measures. Arvis et al. (2013) estimate, using a recently collected World Bank dataset on logistics performance, that improving logistics performance would on average reduce trade costs ten times more than an equivalent reduction in tariffs.

Efficient and reliable transport logistics allow just-in-time and lean production processes.

<table>
<thead>
<tr>
<th>Region</th>
<th>LPI Score</th>
<th>Customs</th>
<th>Infrastructure</th>
<th>International shipments</th>
<th>Logistics competence</th>
<th>Tracking &amp; tracing</th>
<th>Timeliness</th>
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<td>2.69</td>
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<td>2.87</td>
<td>2.79</td>
<td>2.84</td>
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<td>2.51</td>
<td>2.59</td>
<td>2.83</td>
<td>2.67</td>
<td>2.77</td>
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<td>2.79</td>
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<td>2.49</td>
<td>2.41</td>
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</tr>
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</table>

*Source: Connecting to compete: Trade logistic in the global economy of the World Bank 2014*
Table 2. Performance of Arab countries in the 2015 Trading Across Border Indicators

<table>
<thead>
<tr>
<th>Country</th>
<th>Trading across boarder rank</th>
<th>No. of documents to export</th>
<th>Time to export (days)</th>
<th>Cost to export USD/container</th>
<th>No. Of documents to import</th>
<th>Time to import (days)</th>
<th>Cost to import USD/container</th>
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<td>1270</td>
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<td>11</td>
<td>810</td>
<td>8</td>
<td>15</td>
<td>870</td>
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<tr>
<td>Djibouti</td>
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<td>20</td>
<td>885</td>
<td>5</td>
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<tr>
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<td>10</td>
<td>82</td>
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<td>1995</td>
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<td>1065</td>
<td>9</td>
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<td>1560</td>
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</table>

Source: Doing Business Indicators 2015

**Investment openness**

As GVCs are often created and expanded by MNEs, international investment is an important driver of GVC participation. The presence of foreign affiliates in a domestic economy generally indicates greater integration into GVCs and higher import content of exports. An important implication of this is that open and transparent investment regimes is essential to facilitate integration into GVCs. In this respect, ensuring inward FDI openness and that macroeconomic and structural policies support foreign investment. For instance, facilitating mergers and acquisitions could become a crucial channel to spur international investment. Nevertheless, attracting international investment often requires comprehensive and deep reforms, encompassing a large number of distinct policy areas. These include macroeconomic and political stability, rule of law, and corporate governance issues, to name a few.

**The services sector**

The services sector and GVC integration are interdependent. The services sector relies increasingly on domestic and imported manufactured outputs and the “servicification” of manufacturing is an important phenomenon. Restricting access to high-quality, competitively priced imported intermediate goods not only undermines the downstream manufacturing sector but also the services sector that use these inputs. As such, manufacturing exporters has a stake in open and more competitive services markets and services suppliers have a stake in trade liberalization as they directly or indirectly bear part of the costs associated with barriers to goods trade.
Figure 7. Services value added, % of total exports, 2011

Source: OECD-WTO TiVA database, October 2015 release.

Figure 8. Services value-added content of gross manufacturing exports, 2011

Source: OECD-WTO TiVA database, October 2015 release.
**Policy coordination and harmonization**

The internationalization of production has different implications than international trade in final goods. Firms need to effectively manage the flows of goods, services, investment, technology and people across borders to stay competitive and viable. An important implication of moving capital, technology and personnel and actively operating production facilities is that unduly restrictive domestic policies and regulations may constitute a barrier to international trade. A corollary of the rising importance of domestic policies and regulations is a greater scope for cross-border policy spillovers and a stronger case for global policy cooperation. Internationalization of production also means that simple rules such as non-discrimination and reciprocity can no longer guide policy to address trade-related issues (Antràs and Staiger, 2012).

Harmonization of standards and certification requirements and mutual recognition agreement can greatly facilitate the emergence of upstream firms that supply inputs to a large number of destinations.

Limited effectiveness of exchange rate interventions to boost exports. Higher imported input prices negate the favourable price competitiveness effect of exchange rate depreciation.

Given the close link between cross-border capital flows and the emergence and growth of GVCs, restrictions on capital flows are likely to have significant effects on the internationalization of production. The transmission of macroeconomic shocks is facilitated in the presence of supply chain trade. As deeper trade agreements mostly involve behind-the-border measures, changes in domestic policies repercussion for cross-border production.

**Skills**

VI. **GVCs and economic transformation and development**

The rise of GVCs has important implications for the pattern of international trade and investment. In particular, emerging economies assume a more prominent role in the global economy as production activities relocate to developing economies. Initially, GVC participation generally leads to rapid economic growth as new technologies are introduced to labour-intensive sectors. However, as the gains from reallocation of resources freed from lower productivity sectors to manufacturing and technological catch-up taper off and wages rise, the competitiveness originating from low labor costs diminishes and economic growth slows down. This phenomenon is referred to as middle-income trap (Eichengreen et al., 2013).

Participation in GVCs alone therefore do not ensure durable and broad-based gains. Moving up the value chains and additional policy measures are necessary to ensure inclusive growth and better benefit from greater international production networks.

Considering MNEs are key actors that drive the fragmentation of international production and dissemination of advanced technologies, they can be important promoters of structural change in an economy. In this respect, attracting FDI is an important means to facilitate GVC participation.

GVC participation through the foreign affiliates of MNEs could be a risk factor for host economies and may not necessarily generate the anticipated benefits. MNEs are considered to be increasingly footloose and introduce a significant risk of exiting of GVCs for host economies. Such a risk may originate from the global strategies of MNES or other factors beyond the control of host governments in a context of intense competition for destinations.

It is of critical importance to strengthen linkages between local producers and foreign affiliates of MNEs to ensure that trade and investment activities associated with GVCs create value and high quality jobs. This is particularly relevant for foreign investors operating in Export Processing Zones (EPZs), which are relatively isolated production pockets and offer only limited possibilities for linkages with domestic producers. Fostering interaction between foreign and domestic firms to generate spillovers from the activities of MNEs require formulating specific policies. For instance, local content requirements are seen as a way to include domestic firms in the supply chains of foreign affiliates but they often end up providing intermediate inputs in low-technology and value-added segments (OECD perspectives on global development 2013).
VII. Conclusions

Integration into global and regional value chains represents an important opportunity for most countries, among others, to foster industrialization and linkages between the primary sector and the rest of the economy, to reduce heavy dependence on a small number of commodities and products. Most Arab economies appear to suffer from the lack of diversification in their economies and to have difficulty transforming their economies to become more industrial, competitive and better integrated into global markets. In turn, economic transformation and diversification has important implications for sustainable economic growth and job creation. In this respect, countries that need to raise the standards of living to bridge a relatively wide income gap or that need to absorb a high and increasing number of labor market entrants into employment should put special emphasis on fostering the transformation and diversification of their economies. In addition, economic diversification is considered to provide employment insurance, with more diversified economies experiencing lower unemployment during cyclical downturns. It is also argued that more diversified economies tend to be more resilient to external shocks.

Available data evidence suggests that most countries in the Arab region are poorly integrated into global and regional value chains, as well databases that capture various aspects of international production sharing, reflecting the limited capacity of some ESCWA member countries to generate internationally comparable data and to identify policy responses to promote structural transformation and upgrading, based on comparative assessments of countries’ assets, upgrading potential and priorities. Supporting governments to increase their capacities to identify policies and strategies that would help them enter into and gradually upgrade in international production networks in a way that is guided by data evidence and draws on other countries’ experiences entails further work in a couple of areas.

Addressing this data gap is identified by ESCWA as a crucial step in generating evidenced-based policies to foster integration into international production networks. By establishing a feedback mechanism between generating and analyzing data, and policymaking, Arab countries could ensure durable engagement in global and regional chains and maximize benefits from greater integration into international production networks in their domestic economies. The Regional Integration Section is in the process of formulating a project to integrate two ESCWA member countries into the OECD-WTO TiVA database, in close cooperation with the OECD Statistics Directorate. The project also intends to take stock of industrial development and participation into GVCs, with a view to providing evidence for policies and strategies on production transformation and upgrading in GVCs.
**BIBLIOGRAPHY**


