

CAPTURING THE GAINS

economic and social upgrading

Summit Briefing – December 2012

Summit Briefings aim to inform panel discussions and stimulate debate at the Capturing the Gains Global Summit, 'Capturing the Gains in Value Chains', held in Cape Town, South Africa, 3-5 December 2012.

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Economic and social upgrading in global value chains: emerging trends and pressures

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Abstract

The global value chain (GVC) terrain is shifting, with the expansion of regional and domestic chains in Africa, Asia and Latin America. However, expansion is in high-volume, low-price markets, where competition must be balanced against rising costs and higher quality demands. Many sectors face shortages of the skills needed to sustain economic upgrading. Meanwhile, social upgrading does not necessarily follow economic upgrading, with irregular workers (often women) and small-scale producers often experiencing poor remuneration and conditions. Joint action among companies, civil society, governments and donors is needed to link economic and social upgrading and promote more inclusive development within GVCs.

Keywords

global value chains, economic upgrading, social upgrading, leverage, joint action

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Shifting terrain of global value chains

Global value chains (GVCs) are an increasingly important dimension of trade, production and employment. Lead firms coordinate design, production, distribution and retail across borders; what is new is the growing prominence of regional and domestic chains within Africa, Asia and Latin America. These now involve a market of about \$12 trillion, or 36 percent of global gross domestic product in 2012, up from 10 percent in 1980.¹ Accessing higher-income consumers remains important, but expansion is faster in high-volume, low-price market segments.

Economic and social upgrading and downgrading

Capturing the Gains research asked what opportunities and challenges there were for promoting economic and social upgrading within GVCs to benefit workers and small-scale producers. This combined macro trade-level analysis² with meso-level value chain studies in apparel, horticulture, mobile phones and tourism.³

Economic upgrading is defined as the movement of suppliers up the value chain, where they undertake higher-value activities. Social upgrading is the provision of better jobs and rights for workers and small-scale producers.⁴

In general, economic upgrading precedes, but does not necessarily lead

to, social upgrading; in some conditions, this upgrading movement may be reversed. Regional and domestic value chains provide new opportunities for better jobs and remuneration, which means workers and small-scale producers can provide sustained support to low-income households. Economic and social upgrading in value chains is thus essential to more inclusive development.

Major factors conditioning the likelihood that economic and social upgrading will occur together are as follows:

Contract manufacturers and suppliers, who control major supply functions in Africa, Asia and Latin America, have developed their own business strategies for economic upgrading within value chains. These are becoming leading value chain actors.

Reverse innovation has occurred: emerging economy firms develop products to suit low-value high-volume markets, such as inexpensive mobile phones and locally designed apparel. These are fuelling South–South trade and finding their way into some developed economies.

Domestic retailers are adapting centralized distribution to diverse local procurement and consumer contexts. Global retailers are expanding through acquisitions within regional markets.

Quality, price and volume act as barriers to entry, or create downgrading pressures on uncompetitive or smaller firms. They matter in regional value

Notes

1. Atsmon, Y., Child, P., Dobbs, R. and Narasimhan, L. (2012). *Winning the \$30 Trillion Decathlon: Going for Gold in Emerging Markets*. London: McKinsey and Company.
2. Reported in Bernhardt, T. and Milberg, W. (2012) *International trade and the relation between economic and social upgrading*. Capturing the Gains Summit Briefing.
3. See www.capturingthegains.org
4. See Barrientos, S., Gereffi, G. and Rossi, A. (2011). 'Economic and social upgrading in global production networks – challenges and opportunities'. *International Labour Review* 150(3-4), 319-340.





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chains, but different standards apply, opening potential opportunities for producers able to attain requisite capabilities.

Supplier margins are squeezed by rising input costs, price pressures and rising quality standards, with different requirements across value chains.

Tightening supplier margins generates different outcomes, including workload intensification for the existing labour force (e.g. mobile phones) or intensified use of irregular/casual labour (particularly horticulture and apparel).

Quality standards are driving the need for more educated and skilled (often regular) labourers. This creates pressure for better remuneration and conditions.

Reverse upgrading is where social upgrading pushes economic upgrading. Increased wages and a decline in net margins forced Indian IT majors to look for ways of economically upgrading their businesses.

‘Feminization’ in labour-intensive segments: women’s socially acquired skills are critical to quality, but often unrecognized. Women are concentrated in irregular work with lower remuneration and rights or as unpaid family labour in small-scale production.

Productivity and worker remuneration: increased productivity can be an enabling condition for improved workers’ remuneration and rights. But this is not inevitable; it depends on the level of organization and local institutional factors.

When does joint upgrading happen?

Value chain analysis examines linkages between commercial firms, workers and small-scale producers, as well as their wider social and institutional settings. External actors can also affect economic and social upgrading.

The following are examples from Capturing the Gains GVC studies:

Cocoa–chocolate⁵

Over recent decades, the cocoa–chocolate value chain has undergone concentration in processing and manufacturing. Cocoa farmers have received limited support, often have low yields and are poorly remunerated. Media attention has highlighted issues of child labour, and many younger innovative farmers are leaving the sector for better options elsewhere. Consumption of chocolate has grown steadily, especially in emerging economies, with predictions of future cocoa shortages. Leading chocolate manufacturers are working with civil society, donors and governments to support farmers and their communities. Social upgrading is now recognized as critical to economic upgrading – and ensuring the future resilience of the cocoa–chocolate value chain.

Wage increases in Bangladesh⁶

Bangladesh is one of the lowest-cost garment producers in the world. Garment manufacturing in the country has certainly not taken the ‘high road’,

Notes

5. See Barrientos, S. (2012). ‘Beyond Fair Trade: rising corporate concern over socio-economic base of cocoa–chocolate global production networks’. International Fairtrade Symposium, Liverpool, 2-4 April.
6. See Ahmed, N. (2012). *Economic and social upgrading in the ready-made garment sector of Bangladesh: some experiences of minimum wage legislation*. Capturing the Gains Working Paper (forthcoming).

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but over the past few years it has taken a slightly ‘better road’. Increased productivity has led to not only higher wages, but also improved overall working conditions for Bangladeshi garment workers. This outcome has required a series of workers’ struggles, pressure from buyers and then government action to increase minimum wage rates. The important lessons from Bangladesh are that, even at the bottom of the value chain, there is scope for improvements in working conditions, but worker action is often required to turn potential into actual gains.

Apple smart phones⁷

Despite several exposés about poor working conditions in its China assembly operations, Apple made no effort to intervene in the operations of Foxconn, the electronics manufacturer that assembles all Apple products in the country. In early 2012, things began to change. Apple and Foxconn openly admitted to factory problems, and introduced major changes in working conditions and wages. Foxconn announced significant wage increases and conducted an audit of working conditions.

Social upgrading occurred as a result of a number of factors: Apple was motivated by pressure from civil society activists to protect its reputation among international consumers; the

Chinese government strengthened its labour laws, backed this up with real enforcement and decreed substantial increases in the minimum wage; and workers themselves felt empowered to demand better conditions and compensation.

Joint action in tourism in China⁸

Localization of tourism in Lijiang, China, resulted in increased employment and poverty reduction; but a high level of competition among suppliers, combined with oligopolistic buyers, threatened to reduce prices. The local government took the initiative to maintain Lijiang as a premier tourist destination, so it could command a price premium. More importantly, suppliers, including hotels/guesthouses and village suppliers of excursion services, combined at their own levels to reduce competition and support prices and incomes.

An overall finding is that enabling rights (freedom of association and no discrimination) are more difficult to achieve than ‘measurable standards’ on pay and conditions. Where collective bargaining agreements have been instituted, conditions generally improve (e.g. Kenyan and Ugandan flowers). Small-scale producers are better able to access value chains when they are organized (e.g. in horticulture most private standards require group certification and buyers source in volume).

Notes

7. See Mayer, F.W. (2012). ‘Beyond the “business case”’: what the Apple-Foxconn case demonstrates about the interaction among corporate self-governance, civil society, and the re-emerging state’. International Studies Association 53rd Annual Convention, San Diego, CA, 1-4 April.
8. See Christian, M. and Nathan, D. (2012). *Tourism overview: changing end markets and hyper-competition*. Capturing the Gains Working Paper (forthcoming).





Key recommendations

For economic and social upgrading to go in tandem, identifying commercial leverage points and forming alliances between commercial, civil society and government actors appear critical. We recommend key value chain interventions:

- Improve buyer/supplier relationships to reward quality and standards.
- Factor a living wage into value chain pricing. Ensure producer margins are sufficient to cover this and benefits are transferred to workers.
- Enhance training and reward skills (including of female workers).
- Enhance organization of small-scale producers and independent union representation of all workers (regular and irregular).
- Link civil society initiatives (such as ethical and fair trade) with wider government and donor interventions.
- Ensure government and donor policies support value chain upgrading by producers and lead firms within developing economies.
- Support training and education of youth, workers and small-scale producers that link technical skills, social or 'soft' skills and workers' rights.
- Implement core International Labour Organization Conventions and labour legislation through better resourced labour inspectorates.
- As an indirect action, ensure comprehensive social protection for vulnerable irregular workers and small-scale producers.

Capturing the Gains brings together an international research network to examine economic and social upgrading in business communities across the developing world.

The programme explores the connections between business competitiveness and social prosperity with attention to firm innovation, trade expansion, labour standards and decent work.

Its research allows policy-makers and business leaders to better understand the relationship between business growth and poverty reduction in the global South.

Following the Capturing the Gains summit, a revised version of this paper will be made available on the Capturing the Gains website in 2013.