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Effective Participation of Developing Countries and LDCs in Global Value Chains

A Snapshot

By Elodie Arnell and George William Ngobi

Summary

This note focuses on the effective participation of developing countries including Least developed Countries (LDCs) in the Global Value Chains (GVCs). It will provide grounds on how GVCs participation can promote sustainable development and overall international trade integration for stakeholders. This note elaborates on GVCs at the multilateral level and highlights the importance of trade finance for both, Small and Medium Enterprises (SMEs) and Micro Small and Medium Enterprises (MSMEs) growth in the developing countries and LDCs for increased GVCs participation. It highlights Cambodia and her bicycle manufacturing capacity in GVCs to develop some recommendations for developing countries and LDCs.

Introduction

The development of Global Value Chains (GVCs) boosts both international trade and competition as countries and other stakeholders aspire to meet the infrastructural and technical standards or requirements to strengthen their participation in GVCs. To that end, it is evident that developing countries and the LDCs still face challenges in their GVCs participation as the bottom players. Developing countries and LDCs especially those from Africa contribute the least in GVCs. This note finds that the current challenges to GVCs participation can be mitigated by; the implementation of strong trade policy institutions, good infrastructures (roadway, energy access, financial support…) and facilitating Small and Medium Enterprises (SMEs) and Micro Small and Medium Enterprises (MSMEs) growth for domestic capacity building. In the context of GVC participation, Asian countries have already developed transformative industries using mechanisms that could possibly be applied to the betterment of the African economies participation in the GVCs. Among the developing and least developed countries, despite of the progress made in the 21st century, the African continent currently attracts the least Foreign Direct Investment (FDI) and GVCs participation.

As an attribute of multilateral trade integration in the auspices of the WTO, developing and least developed economies have been availed preferential treatment in trade that has increased their market access to the developed economies and reinforced their export competitiveness. In light of recent developments this note elaborates on the Nairobi Ministerial Conference (MC10) of 2015 and the decisions that could possibly improve the participation of LDCs and developing countries in GVCs.

Promoting GVCs in Global Trade

GVCs involve many actors; private, public including services suppliers that are active in the production of goods or services.

GVCs conglomerate a series of activities that add value from the conception of an idea to the development of a product up until its end use and beyond.

According to United Nations Industrial Development Organisation (UNIDO), conversely to producer-driven[1], buyer-driven GVCs are led by large buyers with core competencies in branding and marketing. Moreover, buyer-driven GVCs are highly competitive and globally decentralised. GVCs in the developed countries are largely characterized by subsidiary labour-intensive industries and factories, which face fewer barriers in international trade. In the case of developing and least developed countries, integrating into buyer-driven GVCs in; agriculture, extractive industries, and offshore services and manufacturing could be more economically beneficial.

Trade in global value chains

In GVCs processing stages, intermediate inputs make up the bulk of world trade. According to UNCTAD (2016), trade in intermediate goods in GVCs has increased substantially to US$8trillion (four point increase since 2004) and represent the largest flow in global trade.

[1] *"Producer-driven GVCs are lead by lead firms belonging to international oligopolies in medium- and high-tech industries"* UNIDO (2015), Global Value Chains and Development: UNIDO's Support towards Inclusive and Sustainable Industrial Development, United Nations Industrial Development Organisation

The increase in world trade growth rate can be attributed to increased vertical specialisation as countries participate more in GVCs. According to the World Trade Organisation (WTO) in 2011 nearly half (49percent) of world trade in goods and services took place within GVCs, a significant growth from 36percent in 1995.

Indeed, the services sector contribution in global trade is a cross-cutting issue that is important in the value addition for manufactured products trade. The value added approach shows the interconnection of economies and sectors as well as the increasing importance of trade in intermediates inputs along the global supply and production chains. To date, the centralized vertical view of production sectors is out-dated. It has been replaced with a more organic view of production sectors as integral contributors to GVCs. In order for commodities to gain added value in processing stages, transformation takes place in comparative processes and stages across the globe, in a manner where LDCs and developing countries can participate progressively. With increased participation in GVCs, commodities both for industrial and agricultural transformation as supplied by the LDCs and developing countries would result in overall sustainable trade and development.

GVCs Participation and Expected Impacts

Developing Country Participation in GVCs

Developing countries participation to GVCs varies among regions. The BRICS countries account for a major part of developing countries trade, especially in the trade of intermediates and manufactured products. The participation of other regions is more limited especially for LDCs. Developing countries including LDCs export more unprocessed natural resources than they import in comparison to developed countries. LDCs account for a very low share in global trade. The larger share is in exporting primary goods and importing manufacturing products.

Regarding the attractiveness of their economies, although in 2014 FDI experienced a 16percent-decrease to US$1.23 trillion; FDI inflows in developing economies increased by 55percent to US$681 billion of global total. Nonetheless, inflows vary among developing regions. In 2014, it was driven by developing Asia with a rise to US$465 billion, while flows to Latin America and the Caribbean decreased to US$159 billion and flows to Africa maintained its previous level of US$54billion. FDI inflows to LDCs increased by 4percent to US$23billion, led by Greenfield investments.

Expected Impacts: Opportunities & Main Barriers

Participation in GVCs determines the structure of international trade. GVCs are organized by the coordination of geographically dispersed companies, at different stages of the production lines, which are located in different countries at different development levels.

At the global level, most GVCs leadership is centralized in the developed countries, which fix the structure for industrialisation (i.e. governance, input-output, institutional, territorial...).

At the local level, GVCs provide opportunities for the creation of services, jobs and profits for companies. Through FDI these companies can bring about; technological advancement, technical skills, and increased government revenues through taxes. For LDCs and the developing countries, successful integration into GVCs should create greater shares of those benefits and accelerate industrialization and development.

However, developing countries and LDCs are still faced with major obstacles that inhibit their effective participation in GVCs and stunt their competitiveness. Three categories of barriers can be discerned:

1] The Frequent immediate challenges, which include: Distance to developed market, inadequate domestic infrastructures, limited access to trade finance and the high standards of compliance. The participation of these economies in GVCs is also hindered by; the lack of information, lack a clear comparative advantage, the high cost of market access to developed countries, the centralized structure of value chains, the poor border procedures, inability to attract FDI, poor trade logistic all of which are exacerbated by the lack of both skilled and unskilled labour pool.

2] GVCs structure itself, with competition between countries leading to social dumping[2]. Many multinational corporations (MNCs) are located in dedicated area and benefit from specific schemes such as exemption from taxes or customs duty. (N'Diaye, 2015).

3] Many firms in developing countries suffer from the leader firm's 'nomadism' and from non-tariff barriers. Those firms are generally involved in low paid activities with low value added due to four factors: competitive strategy of key enterprises; nature of the activities of non-key firms; commercial situation of dependency; and provisions of certain international trade agreements (N'Diaye, 2015).

Stakeholder's Integration for Inclusivity and Mutual Economic Benefit

Developing countries are participating more in GVCs despite aforementioned barriers they encounter. They possess large labour intensive populations that although predominantly comprised of low skills, it makes them more competitive when they participate in GVCs, especially the buyer-driven ones.

The integration of all vulnerable group stakeholders (i.e. women and youths and others) is important and should be streamlined as a means of attaining the relevant agendas of the 2030 Sustainable Development Goals (SDGs)[3]. For the latter to be archived, gender inclusion in both economic and social developments schemes has to coincide. According to the World Development Indicators[4], in 2014, while Middle East & North Africa (excluding high income)[5] registered the highest unemployment rate with nearly 13percent of total labour force; East Asia & Pacific (excluding high income)[6] has the lower unemployment rate (4.9percent). It is expected that through GVCs it will have job creation as well as improvement of working conditions. Capacities to foster social inclusion are closely tied to a change in beneficiaries' participation in value chains has to include women and youth, as these groups are

[2] Most MNCs take advantage of the available low skill labor to reduce the overall value cost in the GVCs

[3] Goals: 1, 4, 5, 8 and 10

[4] Consulted on 11 July 2016

[5] Include: Algeria, Djibouti, Egypt, Iran, Iraq, Jordan, Lebanon, Libya, Morocco, Syrian Arab Republic, Tunisia, West Bank and Gaza and Yemen.

[6] Include: Cambodia, Fiji, Kiribati, Macao, Korea PDR, Lao PDR, Malaysia, Marshall, Micronesia, Myanmar, Mongolia, Nauru, Papua New Guinea, Philippines, Samoa, Solomon Islands, Thailand, Timor-Leste, Tonga, Tuvalu, Vanuatu and Vietnam

more vulnerable. Technical skills training and investment promotion are viable options for tackling unemployment i.e. in the manufacturing sector. Employment can either be through capacity building or job creation depending on whether there are job opportunities or that those groups have the required competencies and capabilities.

GVCs at the Multilateral Level

In multilateral trade, it's increasingly difficult to determine where a product comes from because of the inputs both raw materials and the labour into finished products comes from across the globe. It is difficult to credit a product to a source given the multiple stages a product is developed through across the globe. To remedy this issue the WTO's Rules of Origin are important and serve to mitigate trade problems, which may arise in multilateral trade.

In order to enhance LDCs participation in international trade including through GVCs, the Bali Decision of 2013, and subsequent Nairobi Decision on Rules Of Origin provide for affirmative action through enabling policies that would promote their participation in international trade and in particular the production of finished goods. The decisions provide for preferential trade arrangements and permits LDCs to use of up to 75percent of non-LDC originating material when producing goods for export. It also simplifies the documentation and procedure requirements such that they can maintain the right of origin marking.

For its implementation in the current activities in multilateral trade and also in GVCs, the Rules of Origin Committee of the WTO stipulates that developed countries should implement this decision by the end of 2016, and encourages the developing countries that are in the position to implement this decision to commence this preferential treatment for the LDCs as soon as they can. The implementation of this decision will greatly depend on the degree of transparency in trade and private sector activities in the GVCs.

In GVCs activities, all participants are encouraged to be accurate and transparent in their trade transactions and added value calculations with the view to provide the input data necessary at all points of the supply and production chain to allow accurate calculation of the preferential rules of origin for LDCs in GVCs. The quantitative methods to determine whether a GVC product from LDCs qualifies for origin markings will greatly depend on the scrutiny and transparency of the; private sectors, Small and Medium Sized Enterprises (SMEs) and Micro, Small and Medium Sized Enterprises (MSMEs) when reporting costs input of production to their respective chambers of commerce and investment authority. Greater collaboration of the all branches of commerce will be vital in the actualization of these new developments in multilateral trade regime.

Importance of GVCs in trade policies and Aid for Trade (AfT)

The current position is that most SMEs and MSMEs from the LDCs and developing countries lack bargaining power in GVCs. The huge multinationals as chattered for in the GATT 1994[7] make the private standards and technical requirements. The SMEs and MSMEs are expected to involuntary comply with private standards at their own expenses.

[7] Article XVII of the GATT 1994 Article XVII of the GATT 1994 is the principal Article dealing with state trading enterprises (STEs), and their operations. TBT Agreement Article 3 and Article 8

Studies from International Trade Centre (ITC) show that; MSMEs make up an estimated 95percent of all global firms; they employ at least 60percent of the global workforce and account for 50percent of total value added. They are disproportionately important to the livelihoods of vulnerable sections of the workforce, particularly women and youth in the LDCs and developing countries when compared to other economies. Therefore enabling MSMEs to increase; competitiveness through productive capacity, and international access to market and investment, could lead to economic growth and job creation.[8]

The trade and policy status as described above calls for increased collaboration in international trade regime with a view to bridge the gap between the current GVCs policy. Reform is needed to avail a platform for policy convergence that puts into consideration the hardship of MSMEs and SMEs from the LDCs and developing countries in context of participation in the GVCs.

Need for Finance and Investment

To encourage greater participation of developing countries and LDCs into GVCs, a lot of initial investment and infrastructure will be needed to facilitate the above. The current sentiment is that through ratification of the trade facilitation agreement (TFA) and increased multilateral collaboration, members can reduce the cost of export clearance and make trade more time efficient. This is a good multilateral incentive to reducing the difficulty of boarder control procedures when trading.

The TFA can be of great service to assist governments in providing the procedural and technical infrastructure to carry out trade but cannot increase SMEs and MSMEs participation in GVCs. The latter will require financial investments to build the production capacity of the SMEs and MSMEs prior to engaging in GVCs. In other words there is a need to find another source of finance for trade in order to increase the share of profit for the SMEs and MSMEs in GVCs.

Availability of finance being essential for a healthy trading system, today, up to 80percent of global trade is supported by some sort of financing or credit insurance. However, there are significant gaps in provision and therefore many companies cannot access the financial tools they need. Following the 2008-09 economic crisis, SMEs have found it increasingly difficult to access this vital form of credit. The lack of adequate trade finance is particularly acute in Africa and developing Asia.

Trade Promotion for Greater GVC Participations

Trade Promotion Organizations (TPOs) can contribute to growth of SMEs, and Medium enterprises in international trade and increase their profitability when in GVC participation in the context of LDC and developing economies in terms of GDP percentile contribution. . The ITC study *"Enabling MSMEs to participate in international trade"* confirms previous hypothesis that export promotion has spin-off effects on the domestic economy. Firms that benefit from export promotion generate indirect effects. These Spin-offs positively affect the productivity and competiveness of non-exporting sectors. The report found that, *"GDP returns are less than export promotion returns in that; a 1percent increase in exports budgets generate a 0.065percent increase in*

[8] In GVCs participation, SMEs and MSMEs are especially vulnerable to trade barriers that are an exacerbated case for LDCs; they typically export in smaller volumes and therefore have higher export-related per-unit cost than bigger firms and in GVC participation. [*Source*: ITC (2015), *SME Competitiveness Outlook 2015*, available on intracen.org.]

GDP".

The calculations in this report deduce that an equivalent US$1 investment in TPOs is equivalent to US$384 increase in GDP. Therefore for every extra dollar spent in export promotion in the "median country"[9], US$1 investment in TPOs generates US$87 of additional exports thus GVCs participation included creates an immediate financial added value of US$384 increase in GDP (real economic development) for the LDCs and developing countries.

The ITC study *"Enabling MSMEs to participate in international trade"* addresses the missing link for MSMEs inclusive growth. It highlights the importance of concurrent trade promotion investment for export growth and increased GVC participation. When complimented by aid for trade facilities such as the TFA and EIF as envisaged by the WTO[10]. Trade promotion is a means of development because it allows developing countries and the LDC economies to find a means of trade investment outside institutions such as the IMF and the World Bank. Unlike the latter the financial facilities from TPO investments do not come with conditionality or special adjustment requirements. The consumers and the investors directly feel the returns and the economy grows without the accumulations of debt.

Several challenges are yet to be addressed before this approach can be fully implemented in the LDCs and developing economies. Such challenges include; un-packaging of the study into real economic reform for investment. The report stresses that the way trade promotion organizations investment is done matters a great deal for this formula to be productive.

Other Avenues to Increase Developing and LDC Participation in GVCs

Micro and small business incubation centres where small business can acquire the technical training on multilateral rules and the agreements compliance and international tools that can help them get on the path to increased GVC participation.

There is a need for change in the rules, for example in the resolution of trade disputes, where STEs or multinationals are found to be at default of multilateral trade principles, if found to be of great damage or of adverse effect to international trade, where STEs and Corporations are found to be at fault by the WTO, the Dispute Settlement Body (DSB) could establish a mechanism to compensate SMEs and MSMEs that participate in GVCs.

Another means could be through ensuring that anti-competition laws incorporate risk scope for MSMEs and SMEs in order to mitigate the injuries that may result from the big players practices, such as monopoly and the misuse of corporate private standards as they can be great trade barriers when smaller business entities try to export their goods.

There has to be a global recognition of SMEs and their contribution to the world economy and employment. To that end, the United Nations has declared June 16th *"SMEs Global Day".* A day where all members in the intergovernmental and multilateral trade and development institutions, will aim to highlight the importance of SMEs in international trade and their market representation

[9] From this statement it becomes evident that developing countries with access to financial resources for investment for TPOs and export capacity promotion will have increased growth in GDP which may not be the exact output for the same practise in an LDC economy.
[10] TPOs contributed a 5percent-6percent rise in GDP per capita and 7percent-8percent rises in exports. Page 8, TS-2016-4.E.

with the view to study how government policies can be reformed to improve the importance of SMEs in their economic objectives.

Developing countries and LDC governments have to prioritize the SMEs and MSMEs capacity building within their development agenda by incorporating them into both domestic and multilateral trade objectives for development. There is need to under-score the limitations faced by the private sector businesses and produce in the international markets. To supplement the reduction in the cost of doing trade across borders, as envisaged by the TFA, LDCs have to build private sector capacity in order for them to meet the international standards required in GVCs.

The underlying reason for the gap between governments and private sectors in the developing world is that most private business cannot afford trade finance as the rates for borrowing money are too high for small business and only governments can secure these loans for them. As UNCTAD, ITC and the World Bank Group efforts continue, they should incorporate tools for trade finance that are accessible for the small business.

Example of Cambodia: Best practices in the Bicycle (*HS- 8712)* GVCs

To date, Cambodia is classified as an LDC[11] with her main exports being; textile and apparel products, electrical components parts and electronic equipment. Cambodia is well established in the manufacturing of non-motorized vehicles other than railway, tramway, thus bicycles and other cycles.

Today Cambodia is very active in global trade and is among the top five exporting LDCs with a global exports share of 4.3percent. Cambodia's main export destinations are the European Union, the United States and Canada.

As an LDC, Cambodia benefits from export incentives such as; that of the EU's Generalised Scheme of Preferences (GSP), namely the Everything but Arms (EBA) scheme, where Cambodian firms enjoy duty free and quota free market access to the EU in all products but arms. In 2013-2015 most of the bilateral trade in exported goods was mainly dominated by transport equipment.

In the period between 2011 and 2015, Cambodia experienced an annual growth of 33percent in global bicycles manufacturing when compared to the others top manufactures of HS 8712 due to a number of government led trade facilitation reforms the country has undertaken since 2007 as noted below;

] The Cambodian government established the SME Sub-Committee[12] to provide target assistance to SMEs for export capacity growth. The Committee is part of a policy and strategy mechanism of the Royal Government of Cambodia for private sector development and chaired by the Minister of Industry, Mines and Energy (MIME). Her success can also be attributed to other government schemes such as; financing the training of the labour-force, the production sector including agriculture processing, mining and manufacturing. The country has carried out positive reforms in the

[11] Today, Cambodia is close to LDC graduation. The country may no longer be eligible for preferential treatment. They called for an extension of their eligibility after 2016.

[12] (Sub-Steering Committee on SME) was established by resolution No. 45 S.S.R dated August 28, 2007 and recomposed by a resolution No. 27 S.S.R dated November 14, 2008.

services and trading sector which are all vital for the success of Cambodia's bicycle manufacturing and overall participation in this particular GVC both as a Southeast Asian economy and as an LDC.

] In 2007, the Ministry of Commerce (MoC), established a Commercial registration office at its provincial branch in BattamBang Branch to serve businesses in BattamBang, Pursat, Bantay Meachay, and PaiLin provinces. This is an important technical government incentive for trade promotion to reduce procedural challenges for doing business within the country and is an exemplary non-finance trade promotion mechanism for greater participation in GVCs.

] The government of Cambodia has endeavoured to prioritize SMEs development in its national strategies. Cambodia's government has emphasized private sector investments for expansion through the diversification of manufacturing and industrial production to take advantage of the country's natural endowments. The strategy emphasized; promotion of economic growth, generation of employment for all Cambodian workers, implementation of the Governance action plan, and enhancing efficiency and effectiveness in order to reduce poverty and achieve sustainable development.

] The core of Cambodia's strategy has been good governance. By establishing an SME development strategic framework in 2005, the country sought to regulate the implementation of environmentally friendly business attitudes, to finance and support the development of service oriented businesses, and to set out a framework to archive the priority targets as identified. Under the direct supervision by agencies charged with the responsibility to carry out actions for the improvement of SMEs[13] and the overall trade participation in the GVCs. Moving forward the government has continued to improve business climate for SMEs. They are regarded as the fundamental investment for greater GVCs participation. To that end the country has; reduced the requirements and fees for the registration of SMEs in a simplified accounting and finance systems.

Recommendations

Capacity building and cooperation is needed

Developing countries including LDCs have difficulties to implement the necessary policies to support their domestic and international market access and business operation. Governments should prioritize regional cooperation through developing regional value chains within which SMEs and MSMEs can be cultivated and prepared to be more competitive integration in GVCs and global trade.

Financing for increased GVC Participations for LDCs and developing countries;

Investing in TPOs is vital for private sector success. When MSMEs and SMEs have the expert advice on how to meet the technical requirements or standards, for market access compliance, it increases their productivity and output. For capacity building activity to have positive returns on investment, more should be invested in firms that have grown their capacity rather than small

[13] (Sub-Steering Committee on SME) was established by resolution No. 45 S.S.R dated August 28, 2007 and recomposed by a resolution No. 27 S.S.R dated November 14, 2008.

holder business as they yield better outputs in terms of aggregate GDP percentile contribution to economic growth participation in GVCs.

The TPO investments should be concentrated in sectors where the country or economy has great potential to turn a firm into a "Cash Cow" for positive GDP returns[14]. Ultimately countries will have to provide for the reinvestment or reallocation of GDP increment returns in other medium firms for additional exports and increased participation in GVCs to archive cyclical returns from TPO investment using the same formula as prescribed by the WTO/ITC enhancing MSMES and SMEs participation in international trade research[15].

For the LDCs and developing countries, the challenge of information asymmetry is prevalent. In the case of Aid for Trade and other multilateral financial facilities, donor countries cannot always trace the beneficial output from trade development donations. Therefore, it is important that in exercising this formula, aggregated regional statistical data is collected and analysed to confirm results such that TPO donors are reassured of the positive effect their TPO investments have the benefit of SMEs and MSMEs in the end of greater LDCs GVC participation.

Technical Requirement and Standards Implementation:

The standards for GVCs participation remain an inevitable expense for the SMEs and MSMEs in the LDCs and developing economies. As countries endeavour for efficient protection of their consumers, in quality, safety, health and quality compliance assessment procedures on the products in international trade, GVCs demand very high standards.

Developing countries and LDCs GVCs participations could be hindered by the high standard requirements as they aspire to participate in GVCs. The high standards as imposed on the SMEs and MSMEs from the LDCs and developing countries are increasingly costly. To archive international LDCs and developing country equitable and fair participation in GVCs, harmonized and realistic multilateral reforms have to address the SMEs and MSMEs concerns at regional government and WTO ministerial conferences with the view to boost LDCs and developing countries GVC participation.

[14] For the purpose of this report, Cash Cows in MSMEs are those sectors that build on pre-existing export potential.

[15] « The gains from value added capacity development should be defined and reinvested. » Mr. Robert Koopmans, Chief Economist and Director of Economic Research and Statistics, WTO

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This note is authored by Arnell Elodie and George Ngobi

37-39, Rue de Vermont, 1202 Geneva, Switzerland
geneva@cuts.org ● www.cuts-geneva.org
Ph: +41 (0) 22 734 60 80 | Fax:+41 (0) 22 734 39 14 | Skype: cuts.grc

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