

# Policy Brief

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## Upgrading in global, regional and national value chains: Policy lessons from the Tanzanian textiles and apparel sector

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### Abstract

With heightened uncertainties in markets worldwide, attention is shifting from global value chains (GVCs) to regional value chains (RVCs) and national value chains (NVCs) as pathways to industrialisation. Focusing on the Tanzanian textiles and apparel (T&A) sector, our study (Boys and Andreoni, 2020) found that while GVCs made the greatest contribution to recent employment and export growth, firms engaged in intra-African

RVCs and NVCs carried out relatively higher value activities, and RVCs and NVCs can be learning grounds for productive upgrading and strategic GVC integration. To maximize the contribution of RVCs and NVCs to industrialisation, African regional trade agreements should adopt relaxed 'single transformation' Rules of Origin allowing T&A products made from imported inputs to be sold duty free in Africa.

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# Introduction

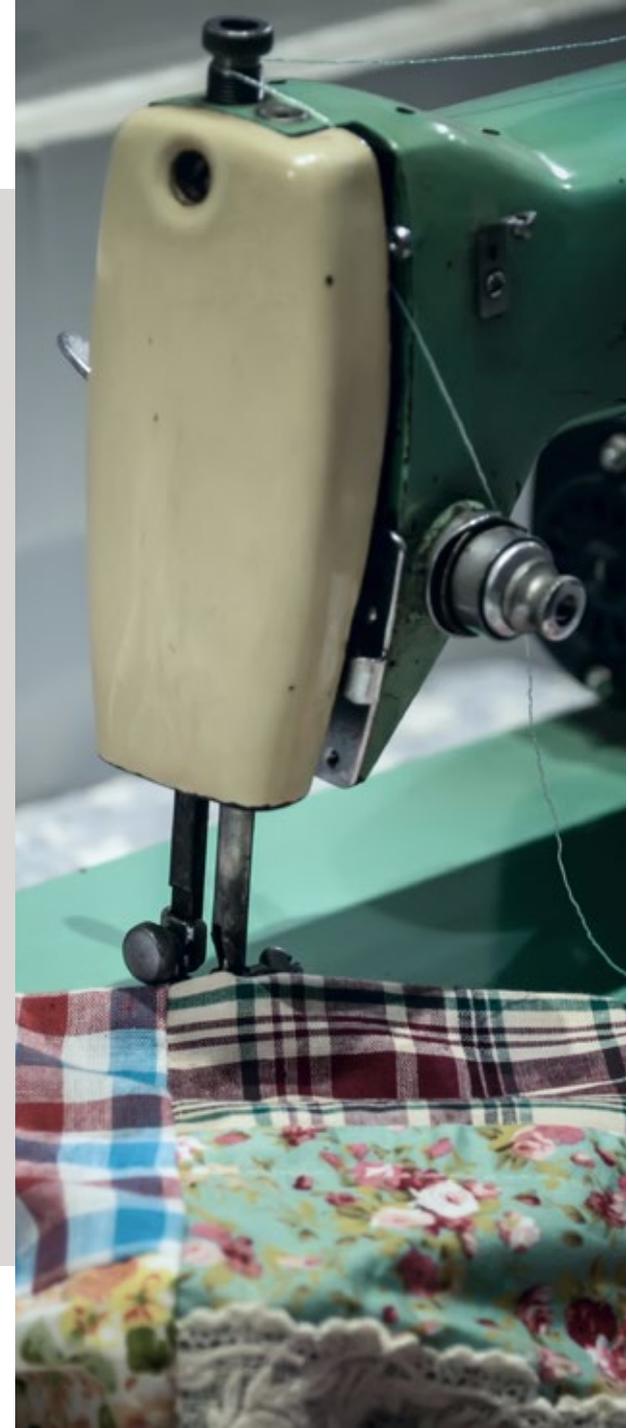
On top of longstanding doubts about the benefits offered by global value chains (GVCs) for development, the heightened uncertainty in global markets due to a breakdown of multilateralism and various exogenous shocks has pushed policymakers to look to regional value chains (RVCs) and national value chains (NVCs) as alternative drivers of structural transformation. <sup>1</sup> Recent breakthroughs towards pan-continental trade agreements in Africa aim to strengthen intra-regional trade and RVCs, but questions remain around the optimal design of these regional policies for the purpose of promoting industrialisation.

This policy brief summarizes the key messages from a recent study of the Tanzanian T&A sector (Boys and Andreoni, 2020). Through a survey of large Tanzanian T&A firms, the study examines how firms' *value chain directionality* – orientation to NVCs, RVCs or GVCs – affects upgrading opportunities and outcomes. It finds that while Tanzania's T&A sector as a whole experienced economic and social upgrading in the 2008-16 period, the different value chain types each offer distinct opportunities for functional, end market, product and process upgrading as well as job creation and backward linkage development.

Drawing on interviews with industry stakeholders, the study also investigated whether industrial and trade policies at the national, regional and global levels support firms to capitalize strategically on the benefits offered by different value chain types. Evidence is presented on a current concern of national policymakers, namely the potential for public procurement contracts to provide rents for industrial upgrading in the context of liberalized domestic markets.

At the regional level, a key policy debate centers on which Rules of Origin (ROO) for T&A products – that determine their eligibility for duty free trade – are most beneficial for promoting industrialisation (Pickles et al, 2015). Within the African Continental Free Trade Area (AfCFTA), negotiations are ongoing about whether the bloc should opt for more strict 'double transformation' rules for T&A products requiring local sourcing of inputs, or more relaxed 'single transformation' rules allowing manufacture from imported inputs (UNCTAD, 2019). Drawing on Tanzania's experience, recommendations are offered to AfCFTA policymakers.

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<sup>1</sup> The Covid-19 pandemic and global trade wars are among the main drivers.



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## Key Messages

### Value chain directionality matters for development

GVCs, RVCs and NVCs each offer distinct opportunities for upgrading and other policy priorities.

#### Functional upgrading

GVC-oriented firms focus on a narrow range of lower-value functions – mostly apparel assembly – while firms oriented to RVCs and NVCs perform a wider range including vertical integration to textile manufacture (i.e. producing their own yarn and fabric inputs) and higher-value activities (e.g. design and branding). Only one recent case of functional upgrading was found, an NVC firm which started to manufacture clothing.

#### End market upgrading

Results in the area of end market upgrading confirmed that NVCs and RVCs can serve as ‘learning grounds’, or ‘stepping stones’ to more demanding but lucrative global markets. This is demonstrated by the case of a firm that built its production capabilities initially as an own-brand manufacturer (OBM) in domestic markets, then learnt to export by serving the South African market, before recently being able to start meeting the higher requirements of US buyers.

#### Product and process upgrading

Process upgrading was observed in all groups but GVC firms were closest to the technological frontier, followed by RVC and NVC firms. The only recent case of product upgrading was by a GVC firm.

#### Development outcomes

GVC firms have made the greatest contribution to recent employment generation and export growth. NVC firms performed best on local content by sourcing Tanzanian cotton, while some RVC and GVC firms also procure local cotton depending on firm set-up but otherwise depend on imported inputs. Ownership is important to understand many of the outcomes mentioned (Morris et al, 2016) and notably all GVC firms in Tanzania are foreign owned, while all RVC and NVC firms are locally owned.

### Multi-scalar industrial and trade policy

Rents allocated through trade and industrial policies at the global, regional and national levels were critical for the outcomes seen.



### Global level

Unilateral trade preferences granted under the USA's African Growth and Opportunity Act (AGOA) are the main driver of Tanzanian integration into T&A GVCs, with AGOA rents underpinning recent investment and job creation in Export Processing Zones (EPZs). Crucially, AGOA's relaxed 'single transformation' ROO allow T&A manufacturers in Tanzania to import their inputs but still benefit from duty free market access to the USA. The scheduled expiry of AGOA in 2025 is prompting GVC firms to reconsider their business models, resulting in the only case of product upgrading found. Uncertainty over AGOA's future is already reducing incentives for new investment, with investors interviewed preferring at least a 10-year time horizon of policy stability. Policymakers should prioritize securing the continuity of market access to the US without opening domestic producers to further competition.

### Regional level

By removing trade barriers, regional trade agreements (RTAs), especially the Southern African Development Community (SADC) and East African Community (EAC) were important sources of rents for RVC-oriented firms. Yet despite Tanzania's privileged access to the highly prized South African market, the restrictive 'double transformation' ROO in SADC for T&A products have resulted in negligible

new investment. This suggests policymakers negotiating the design of ROO in the Tripartite Free Trade Area (TFTA) and AfCFTA should be skeptical of the idea that double transformation ROO for T&A products will create sufficient incentives for new investment in the regional cotton-to-clothing value chain. Instead, more relaxed ROO favoring export-oriented apparel producers might eventually result in a backward linkage effect (i.e. new investment in textiles manufacture) by creating a critical mass of demand for fabrics, as seen in the case of Ethiopia (Whitfield et al, 2020).

### National level

Opportunities for upgrading in T&A NVCs are constrained by the highly competitive Tanzanian market created by liberal trade policies towards imports of new and especially second-hand clothes, such as low tariffs and undervaluation by customs authorities. Firms called for efforts to remediate this situation but acknowledged the political challenges involved, despite the policy rhetoric around building an integrated cotton-to-clothing NVC. In the absence of market reforms, public procurement contracts and duty remission schemes have provided targeted rents to compensate for the adverse context, resulting in the only case of functional upgrading found in Tanzania – a model which could be replicated.

## Conclusion

Although foreign-owned GVC-oriented firms have made the greatest recent contributions to product upgrading, employment generation and export growth, domestically-owned NVC and RVC firms perform a wider range of higher value activities, procure more inputs locally and have engaged in functional and end market upgrading. Policy rents were key to explaining the outcomes seen but there is scope to refine multi-scalar industrial policies to combine the benefits of each value chain type more strategically. For instance at the regional level, single transformation ROO should be prioritized in trade agreements to maximize prospects for industrialisation. At the national level, efforts to provide targeted rents for functional upgrading, e.g. through public procurement contracts and duty remission schemes, should be scaled up.



## References

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