

GVC positioning of countries and income inequality: A global empirical assessment

Topic: The Reconfiguration of Global Value Chains in an Era of Growing Uncertainties

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A growing literature has stressed that the geographical dispersion of production and the subsequent rise of global value chains (GVCs) are associated with important social and economic disparities across countries. In fact, several contributions have shed light on the uneven distribution of value captured by economies and their different opportunities to upgrade from low to higher knowledge-intensive activities along GVCs.

However, systematic empirical evidence on the distributional consequences of GVCs within countries has so far been rather limited. In this work, we take a step forward in the direction of filling this gap by providing a global empirical assessment of the GVC-inequality nexus. Our analysis is performed on a sample including more than 100 countries over the period 2003-2018 and contributes to the extant literature in the following three respects.

First, we use indicators of trade in GVCs based on Multi-Regional Input-Output tables in order to empirically assess the heterogeneous impact of different forms of participation in GVCs on within-country income inequality for both developed and developing economies.

Second, we combine information on the GVC position of countries based on input-output tables with detailed data on inward foreign direct investments (FDIs), which include information on the value chain activities they are aimed to perform. Cross-border capital flows have represented indeed a key driver of the international fragmentation of production and have largely contributed to the involvement of low- and middle-income countries in GVCs. This allows us to complement analyses on the impact of trade in GVCs on income inequality with evidence on the value chain activities in which countries are involved.

Third, we introduce and compute a measure of “functional diversification in FDI” namely an indicator which captures the ability of countries to attract FDIs in a more diversified set of economic activities in order to investigate the role played by the diversification of economies in terms of value chain functions in affecting their level of income inequality. Our research hypothesis is that higher GVC participation of economies combined with greater functional diversification “as opposed to hyper-specialization” can have a beneficial effect on income distribution within countries by enabling economies to expand their production matrix and foster a more inclusive development. In fact, while performing a limited set of activities in GVCs would merely reduce the variety of capabilities that they have, a greater functional diversification can sustain a larger and increasingly diverse set of skills, therefore promoting a more even distributional outcome.

By jointly considering both FDI and trade modes of countries’ involvement in GVCs, our empirical analysis therefore allows: (a) to distinguish the distributional impact of more captive or hierarchical type of governance of GVCs from that resulting from firms’ international outsourcing strategies (which greatly fuels trade in intermediate inputs within GVCs); (b) to better control for the omitted variable bias that might arise when failing to include both these forms of countries’ involvement in GVCs.

Our preliminary results show that (i) the association between trade in GVC and income inequality is conditioned by the GVC position of countries in terms of backward to forward GVC linkages and by

their level of economic development; (ii) countries attracting a larger share of FDIs in the upstream and downstream value chain functions report lower income inequality, while the opposite emerges for economies drawing mainly FDIs in production functions; (iii) countries characterized by a greater functional diversification in FDI exhibit a more equal distribution of income, which appears consistent with the hypothesis that a larger mix of value-adding activities an economy carries out allows to expand the learning opportunities and occupational choices for its workers and is conducive to a more inclusive development.