Participation in global value chains and its role in the treatment of Dutch disease

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Received: 11/05/2024 Accepted: 15/06/2024 Published: 27/06/2024

Abstract:

With the continuous drop of prices over no signs of any short term growth and recovery period in global energy markets and oil especially; which turned into being an economic phenomenon known before as the "Dutch-disease" or what is known also as the “resource curse”, or the “paradox of plenty” which have long effected energy-based economies like most of Arab countries, some Latin Americas...etc. This crisis pushed them to find urgent solutions to control the spread of this economic disease, and perhaps the most prominent of these solutions is to diversify its manufacturing base destined for export, in order to find other sources of national income, and why not diversify their economies and transform them to the advanced industrial economies over the long term, as we will try in this paper to explain and propose a solution that can be of the most prominent solutions at the moment, namely participation in the global value chain.

key words: Dutch-disease ; diversify ; global value chain ; growth.

Jel Classification Codes:O40;

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1. Introduction:

The term "Dutch Disease" describes the predicament faced by countries with a surplus of natural resources, which hinders their ambition for sustainable and stable economic diversification. Access to funds derived from natural resources can lead to several challenges, including currency appreciation, competition concerns in specific industries, and over-reliance on one sector. GVCs offer a potential cure for the Dutch disease by enabling countries to capitalize on their natural wealth while diversifying their economic activities .

GVCs have not only changed the world, they have transformed it. Countries that once struggled have now found a path to prosperity. Thanks to this shift in accessible development options, these countries have engaged in supply chains without spending much time creating their supply chains. Outsourcing labor-intensive industrial processes and the subsequent global transfer of technology have led to remarkable growth in these countries, painting a promising picture for their future. (Baldwin, 2012, p. 1).

Instead of relying on a single source of national revenue, this will ultimately undermine these countries' economic performance and make them vulnerable. As previously mentioned, the solution to this significant disruption may be to reduce dependence on a single source of income and seek diverse alternatives. This is the concept we want to clarify in this study.

Objectives of the study :

- Promote the significance of engaging in global value chains to reduce the Dutch disease's adverse effects and stimulate economic diversification .
- Offer an extensive comprehension of the Dutch illness phenomenon and its impact on economies relying heavily on natural resources .
- Examine possible solutions for the Dutch illness, explicitly considering the impact of global value chains .
- Provide concrete instances of countries that have effectively mitigated the adverse effects of the Dutch disease by actively engaging in global value chains .
- Extract insights and provide suggestions for nations with comparable difficulties.

2. Historical Context and Definition

The recurrence of historical events is a common phenomenon, and this is especially noticeable in the realm of economics. An examination of economic history reveals intriguing similarities in the difficulties that economies encounter. Consider the 16th century, during which towns such as Geneva, Amsterdam, and London emerged as major global economic centres, despite their emphasis on the textile industry and limited availability of natural resources. On the other hand, towns such as Lisbon and Madrid, who received abundant amounts of gold and silver from their colonies, did not attain comparable levels of economic prosperity. Miguel de Cervantes Saavedra, a famous Spanish writer from the 16th century, made this perceptive remark in his enduring masterpiece, Don Quixote de la Mancha: "Greed does not stem from owning wealth, nor from spending it extravagantly, but solely from its prudent utilisation» (Chakouri, 2012, p. 3).

As mentioned earlier, history often repeats itself. In 1959, significant fossil fuel reserves were discovered in the North Sea, particularly in areas of the Netherlands. This discovery led to a substantial decline in the Dutch economy, resulting in a contraction of the manufacturing sector between 1959 and 1971. The British magazine The Economist, in its 1977 issue, drew attention to this new economic malady, coining the term "Dutch Disease" to describe the adverse effects of natural resource abundance on other sectors of the economy, especially the manufacturing industry. This prompted economists to delve into understanding this peculiar phenomenon, highlighting the adverse consequences of increased natural resource exports on the diversification of economic sectors. (Chakouri, 2012, p. 12).

The term' Dutch Disease', coined by Corden and Neary in 1982, describes a potentially severe economic condition that can afflict countries with abundant natural resources. This condition, which can be particularly detrimental to developing nations, arises from a sudden increase in the extraction of natural resources. The main argument revolves around the impact of a surge in the export of natural resources on the domestic economy and other sectors. (Corden & Neary, J. P, 1982).

Corden (1984) elucidated the notion by emphasizing that an increase in the exportation of natural resources might result in the appreciation of the home currency, sometimes referred to as the "Dutch disease effect. As a result, the value of this currency decreases, which reduces the ability of other businesses, particularly the manufacturing sector, to compete in the global market for tradable goods. Any decline in competitiveness may lead to a reallocation of resources to other industries, which will inevitably affect labor, which in turn will migrate to sectors that are more profitable (Corden W. M., 1984).

3. Impacts of the Dutch Disease:

Dutch disease is a multifaceted economic phenomenon that can affect a country's economy and growth trajectory in many ways. It is commonly linked to economic consequences such as the increase in value of the local currency and the decrease of typical export sectors. However, it extends beyond than that to encompass other consequences, which we shall outline in the subsequent sections

3.1. Exchange Rate Appreciation and Manufacturing Decline:

The primary consequence of Dutch disease is currency appreciation, which often occurs when a country starts exporting large quantities of natural resources, leading to a surge in foreign exchange earnings. This can also be triggered by foreign capital inflows, resulting in an appreciation of the domestic currency, lower prices for imported goods, and reduced export competitiveness (Corden W. M., 1984, p. 368). The most concerning aspect is the impact on the industrial and agricultural sectors, which are the backbone of employment and economic growth. They may suffer, leading to a decline in their competitiveness in both domestic and international markets(Sachs & Warner, 1995, p. 14).

3.2. Allocation of resources and diversification of the economy:

The Dutch Disease can also influence a country's long-term economic development by affecting the allocation of resources and the diversification of the economy. As the natural resource industry grows, it has the potential to draw elements of production such as labor, money, and entrepreneurial skills from other (Auty, 2001, p. 844). This might result in a scenario where the economy becomes too dependent on the natural resource sector, sometimes called "Dutch Disease Syndrome" (Ifediora, 2012, p. 5). The high concentration level might impede economic diversification, making the country susceptible to changes in commodity prices and the possibility of resource depletion (Addisu A Lashitew, Michael L Ross, & Eric Werker, August 2021, p. 165).

3.3. fiscal Policy and Government Spending:

The revenue windfall from natural resource exports can also impact fiscal policy and government spending. If not appropriately managed, this revenue can lead to excessive government spending, often called "Dutch Disease spending," that weakens competitiveness and contributes to human capital being drawn into low-productivity government jobs rather than the private sector. Such a public-sector boom and the resulting distortionary spending can result in crowding out private investment, distorting the economy, and creating an unsustainable fiscal situation when resource revenues decline. (James Cust, Shantayanan Devarajan, & Pierre Mandon, 2022, p. 11) . On the other hand, if revenues are saved and invested wisely, they can contribute to long-term economic stability and development (van der Ploeg, 2011, p. 377).

3.4. Social and Political Impacts:

The Dutch Disease can also have significant social and political consequences, particularly the severe 'resource curse.' This term describes the trend where countries rich in natural resources tend to have poorer development outcomes, including higher levels of corruption, income inequality, and social conflict. This is often attributed to the concentration of economic power, the distortion of political institutions, and the potential for rent-seeking behavior (Mehlum et al., 2006). (Mehlum, H., Moene, K. O, & Torvik, R, 2006, p. 3).

4. Participation in the global value chain and its economic implications:

Economic diversification has become an inevitable solution, as evidenced by most, if not all, economic studies, especially in light of the deepening crises in countries dependent on natural resources. These countries are now grappling with the consequences of what is known as economic singularity, which has proven to be fragile, unsustainable, and unstable. This is because their economies lack solid foundations and a diverse production, financial, and service base, which are necessary for generating multiple sources of sustainable income. This has prompted these countries to seek new approaches and policies to change their reality and avoid the pitfalls of their current path. This has led the International Monetary Fund (IMF) to issue warnings about the need for economic diversification to address these imbalances.

With the emergence of new production systems adopted by large multinational companies, often referred to as transnational corporations, the internationalization of production, and the division of labor and distribution of production lines geographically, the nature of production processes has transformed. In today's world, a consumer product often passes through multiple stages and regions before reaching the end consumer. For instance, a car manufacturer might source an engine from Germany or China, electrical wiring from Taiwan, an exhaust filter system from Brazil, and then assemble the car in Turkey. This fragmentation of production processes and the international distribution of tasks have given rise to transnational production systems, commonly referred to as Global Value Chains (GVCs). Initially, GVCs were predominantly present in industries where activity separation was straightforward, such as electronics, automotive, and textiles and apparel. However, they have rapidly expanded to encompass other sectors, including services, due to their close linkage with manufacturing exports. As a result, GVCs have grown exponentially and spread worldwide

4.1. Understanding Global Value Chains:

Global value chains (GVCs) are distinguished by the international exchange of industrial processes. This entails the fragmentation of production into various activities and tasks across many nations. They represent a significant broadening of the concept of work division that began in the time of Adam Smith. According to Smith's well-known depiction, the production process of a pin was divided into several activities within a factory, with each activity being carried out by a specialist worker. Global Value Chains (GVCs) encompass the worldwide dispersion of economic activities, without being confined to a certain geographical region. The products manufactured within Global Value Chains (GVCs) are far more complex than an ordinary needle. (Adnan Seric & Yee Siong Tong, 2019). Global value chains (GVCs) involve a wide array of activities, such as design, production, marketing, and distribution, that frequently take place in many countries. . (Baldwin, 2012, pp. 12-13).

4.2. The extensive proliferation of global value chains and their importance in fostering economic growth and progress:

According to a recent report presented at the G20 Summit in 2013, global value chains (GVCs) have become the predominant feature of international trade and investment. Global Value Chains (GVCs) provide novel prospects for economic expansion, advancement, and job creation. The paper "The Impacts of Global Value Chains on Trade, Investment, Development, and Employment" states that in order to effectively participate in Global Value Chains (GVCs), it is necessary to make significant investments in technology dissemination, skills development, and upgrading .As stated in the same research, Global Value Chains (GVCs) make a substantial contribution to development. Value-added commerce in poor nations makes for around 30 percent of their GDP, whereas in affluent ones it accounts for around 18 percent. There is a clear and positive relationship between involvement in Global Value Chains (GVCs) and the growth rates of per capita Gross Domestic Product (GDP). This relationship has direct economic effects on value-added, income, and employment. Additionally, they can serve as a crucial method for developing nations to enhance their ability to produce goods and services by facilitating the spread of technology and the acquisition of new skills, hence Facilitating prospects for sustained industrial growth. (UNCTAD, 2013)

The proliferation of trade and investment by multinational firms and other organisations has been intricately connected to the development of worldwide production networks, sometimes referred to as value chains, with a special emphasis on Asia. These networks have sparked a revolution comparable to a third industrial revolution by breaking down production processes into many phases that span across different countries. Consequently, emerging nations have successfully broadened their industrial framework and become involved in more intricate involvement. At first, they were mostly engaged in labor-intensive tasks, such as assembling. Later on, they advanced to producing components and manufacturing equipment. Simultaneously, less advanced manufacturing methods were relocated to nearby less industrialised regions. Simultaneously, these industrial operations generate a need for local enterprises to provide them with essential manufacturing components and services. Newcomers to the worldwide production environment, such as Malaysia in the 1970s, Thailand in the 1980s, China in the 1990s, and recently Vietnam, have increased their chances of participating by expanding their prospects. ((UNDP, 2013, p. 50.(

In addition to international reports, a study published in the March 2014 issue of Finance and Development by Michele Ruta and Mika Saito, titled "Chained Value" drew three broad conclusions. First, global value chains generate wealth, but at different speeds within and across countries. Second, these chains influence the concept of competitiveness, giving it greater significance in understanding how companies produce across multiple borders. Finally, these value chains increase interdependence among countries, underscoring the urgency for policy cooperation. These findings have direct implications for policymakers. (Michele Ruta & Mika Saito, March 2014, p. 55)

Here are some positive aspects that countries can gain from participating in Global Value Chains (GVCs): (UNCTAD, 2013, pp. 23-24)

- GVCs can accelerate the convergence of developing countries with advanced economies in terms of Gross Domestic Product (GDP) and income levels.
- There is an increase in the growth rates of GDP per capita in economies that are increasing their participation in GVCs at a faster rate than others, estimated at two percentage points above the average.

- GVCs provide job opportunities and increase employment rates in developing countries, even if participation in these chains is linked to imported content constituting their exports.
- GVCs offer a significant avenue for developing countries to build productive capacities, including technology transfer and skill development, providing opportunities for industrial upgrading in the long run.
- In terms of national companies, the opportunities for local firms to enhance productivity and move towards higher value-added activities within GVCs are linked to the nature of the chains in which they operate.
- Gradually moving up in GVCs, i.e., transitioning from resource-based exports to exports of manufactures and services with increasing technological complexity, will, in the long run, enable developing countries to acquire a robust industrial base and transform from technology importers to innovators.

Regarding countries' participation, especially developing ones, in Global Value Chains (GVCs), the same report recommended it with some reservations, titled "Countries face a strategic choice: to foster or not to foster participation in Global Value Chains." It is considered a strategic decision that falls within long-term development plans after highlighting the strengths and weaknesses of participating in GVCs. The report suggested that before making a decision, "countries should carefully compare the positives and negatives of participating in GVCs, and the costs and benefits of proactive policies to foster GVCs or GVC-led development strategies, according to each country's specific situation and factor endowments. Some countries may decide not to foster GVC participation. Others may have no choice: most small developing economies with limited resource endowments often have no alternative but to pursue development strategies that involve some degree of GVC participation. The question for these countries is not whether to participate in GVCs but how to participate. Most of these countries already participate in GVCs in one way or another. Enhancing chain participation involves targeting specific sectoral segments, i.e., fostering chains can be a selective process. Moreover, chain participation is one aspect of a country's comprehensive development strategy." (UNCTAD, 2013, p. 25).

The report also outlined the optimal approaches for countries intending to enter GVCs, benefit from their participation, and ascend within them. It emphasized that mere participation does not yield significant gains; instead, climbing the ladder within these chains is crucial to reaping their full benefits and transforming from a simple resource-exporting country to one exporting diverse, highly competitive goods on the international stage. Ascending the GVC ladder will enable countries to acquire a robust and diverse industrial base, averting the pitfalls of a singular economy.

One crucial step towards building GVC policies is to pave the way for their creation, and one of the best ways is through trade liberalization and regional industrial development agreements. This is a clear indication of the need to establish export-oriented special industrial zones, as they are closely linked to GVCs, as mentioned earlier since GVCs involve the fragmentation and division of global mega-factories.

Expanding supply chain-based trade and associated Foreign Direct Investment (FDI) flows into production facilities has significantly reduced countries' incentives to utilize trade policy instruments such as tariffs. Specialization in supply chains requires companies to be able to import products and services that they will subsequently process and export. Providing substantial protection to imports would increase costs and undermine the competitiveness of companies operating within these supply chains. (Hoekman, December 2013, p. 23)،Therefore, establishing free manufacturing and export zones encompassing these advantages is the optimal approach to paving the way for participation in global value chains. These are several benefits we mentioned earlier. The best example to emulate is the experience of Asian countries.

This is due to the close and positive correlation between intra-regional trade and export growth to the rest of the world, with living standards in the region converging towards those of high-income countries. However, we concluded that regional integration itself is not the decisive factor in East Asia's growth components. Instead, the critical element is the way these countries implement integration. The link between intra-regional trade and growth in East Asia reflects two significant trade patterns: a large volume of trade within a single industry, i.e., trade flows within narrowly defined sectors or industries, such as electronics and heavy machinery, and high participation in Global Value Chains, where trade is linked to multi-country production processes. For instance, a car manufacturing company might produce gearboxes in one country and car bodies in another and export these parts to a third country where the vehicle is assembled. The share of intra-East Asian exports has increased since the 1970s from about 30% to roughly 55%, and total exports have soared. Alongside these achievements, living standards in East Asia have approached those of the United States (Augusto de la Torre, Daniel Lederman, & Samuel P, September 2015, pp. 28-29).

5. Various instances from different countries demonstrate how engagement in Global Value Chains (GVCs) has effectively mitigated the negative effects of the Dutch disease and facilitated economic diversification:

5.1. Norway :

Norway, a significant oil-exporting nation, has effectively mitigated the adverse effects of the Dutch plague. The nation has a robust presence in many Global Value Chains (GVCs), such as the marine, renewable energy, and high-tech sectors (UNCTAD, World investment report: Investment and new industrial policies., 2018, p. 81) The government has enacted measures to foster economic diversification, such as channelling oil earnings into a sovereign wealth fund that serves the interests of future generations and fosters enduring economic stability (van der Ploeg, 2011, p. 821). As a result, Norway has been able to sustain a competitive non-oil industry and achieve a high quality of life.

5.2. Chile:

Had a significant increase in copper exports throughout the 1990s, resulting in a rise in the value of its currency and worries about the manifestation of Dutch disease symptoms. Nevertheless, the nation effectively expanded its economic activities by integrating into Global Value Chains (GVCs), particularly in the agriculture and mining industries (Alvarez, R & Fuentes, J., 2017, p. 51).Chile had robust connections with multinational corporations, drawing in foreign direct investment and the transfer of advanced technology. As a result, it emerged as a central centre in the area for services associated with mining and agricultural.

5.3. Malaysia L:

Exemplifies effective diversification through its engagement in Global Value Chains (GVC). The nation initially mainly depended on the exportation of natural resources. However, by implementing certain industrial strategies, it successfully established a significant position in the global value chains (GVCs) of electronics (Milner, C. P & Reed, G, 2015, p. 752). Malaysia successfully attracted Foreign Direct Investment (FDI) from international firms, cultivated a highly qualified workforce, and built a strong network of local suppliers. This facilitated the country's efforts to broaden its range of exported goods and sustain its ability to compete amidst the strengthening of its currency.

6. Conclusion:

Given the volatility and unpredictability of oil prices, relying solely on this source of income is no longer sufficient for developing plans. The significant impact of oil on geopolitical factors and international events has made it unstable, even becoming a burden for its owners. Therefore, it has become imperative for countries aspiring to a prosperous future to explore alternative sources of income, in order to establish economies that are more resilient. Recent studies and global conflicts have demo:

- ✓ The economies of oil-producing developing countries، such as Algeria، are heavily reliant on the oil sector to fund government budgets and support the development process .
- ✓ Therefore، these countries must make significant efforts to enhance their capabilities in order to establish an alternative production base that can meet the demands of economic development. This can be achieved by promoting investments - in alternative and manufacturing industries, particularly as an initial step.
- ✓ The user did not provide any text. The shift from a single-focused economy to a diverse economy, such as a knowledge-based and industrialised economy that can effectively address future difficulties such the exhaustion of oil resources.
- ✓ The user's text is empty. Free industrial export zones, particularly in developing nations, are crucial for facilitating global value-added commerce and serve as a significant catalyst for attracting foreign direct investment .

- ✓ The user did not provide any text. By incorporating global value chains into industrial development strategies and establishing ambitious objectives to engage in these chains and progress from lower-tier countries to higher-tier countries that exert influence over them. - Establishing a versatile administrative structure with complete autonomy to oversee these strategies, with the aim of fostering a competitive environment for investments .
- ✓ Establishing an advantageous investment climate to promote the growth of non-extractive productive industries، with the aim of enhancing their contribution to the Gross Domestic Product (GDP) by collaborating with the private sector and engaging in regional and international accords.

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