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Introduction¹

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Since the 1970s and 1980s, Asia, and especially China, has become the factory of the world. To a lesser extent, India has become the back office of the world. These momentous shifts in the location of global economic activity have fuelled economic growth in the emerging economies of Asia: between 1995 and 2009 income from global value chains (GVCs)-related trade increased 6-fold for China and 5-fold for India (OECD, WTO, UNCTAD, 2011). The GVC trade accounts for about 30 per cent of GDP of developing countries (UNCTAD, 2011). Many of the new employees in GVCs, whether engaged in electronics, garments or IT services, include large numbers of women, which evokes notions of transformation in Asian labour markets. Poverty in developing Asia has also decreased: it is in single digit figures in East and Southeast Asia, though most of South Asia still lags behind, with poverty levels at three times or more than those found in East and Southeast Asia (World Bank, 2014).

In the midst of this unparalleled growth and transformation, there are all-too-frequent stories of disasters—whether of suicides by workers in China in electronic assembly factories or of fires and factory collapses in Bangladesh—that kill hundreds of workers. In the midst of unprecedented advances, there are also serious problems and the benefits of GVC-led growth are deeply uneven. It is thus necessary to ask how and to what extent labour has benefited from the advances of firms and economies in both manufacturing and service production in the developing countries of Asia. Who benefits and why, who does not and why not? What are the reasons that limit these benefits? And, going forward, how can labour in Asia benefit more substantially from economic growth in the region?

These are some of the questions that motivate this book. The book is itself a product of a larger research collaboration on the study of economic and social

¹ We thank Jennifer Bair, Stephanie Barrientos, Raphie Kaplinsky, Govind Kelkar and John Pickles for helpful comments at various stages of writing this Introduction.

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upgrading in GVCs as part of the Capturing the Gains (CtG)² initiative. The CtG project brought together a large network of scholars who carried out research on these themes in a number of countries and sectors. In this book, however, we also include some studies that were not part of the CtG Project but became part of the larger collaboration it fostered.

The book brings together studies on labour in GVCs across several Asian countries: Bangladesh, Cambodia, China, India, Indonesia, and Sri Lanka. The studies cover a number of sectors spanning the agrarian economy (agro-foods), manufacturing (garments, electronics, automobiles), and services (information technology [IT], software services, and tourism). Given the wide country and sectoral coverage of the case studies reported in the book, this volume may be considered reasonably representative of labour trends in developing Asia as a whole, in the context of the growing incorporation of Asian economies as supplier nations in GVCs across a range of sectors.

In the rest of this introductory chapter, we set forth the conceptual framing of the relationship between lead firms, supplier firms and labour in GVCs,³ and the geographies in which these relationships are embedded as the analytical context for the case studies that follow. This conceptual framing discusses both the distributional issues and business practices that shape GVCs and their governance structures. We then examine how these governance structures in turn interact with a variety of sector- and country-specific institutional factors that influence employment conditions within GVCs, particularly in Asia. Specifically, we focus on the interaction between profits, rents, and conditions of value capture as forces that shape ‘vertical’ relationships between lead firms and supplier firms within GVCs. Similarly, the interaction between wages, knowledge, skills, and ‘governance’ rules (control and flexibility) shape the horizontal relationships between supplier firms and labour. Together, they produce the wide variation in employment conditions and bargaining power that we see in various places and cases on the ground.

² The CtG research program was led by Stephanie Barrientos of Manchester University and Gary Gereffi of Duke University.

³ There is a considerable literature using the term global production networks (GPNs)—see for example, Dicken (2007) and Coe et al. (2008). We do not go into the debate about which metaphor, chain or network, more correctly represents the nature of splintered production, but use both terms GVC and GPN interchangeably. Some of the authors in this book use the term GVC while others use GPN.

1.1 Buyer and supplier relations: Locating labour within GVCs

We begin with the evolving relationships between buyers and sellers in various institutional contexts, including GVCs. At the economic level, one can distinguish three types of stylized relations between buyers and sellers.

The first is that of *arms-length purchase*, i.e., the kind of transaction that characterizes the vast majority of commodity trades. Sellers and buyers get together, bids are made, and money and goods are exchanged. In these atomistic, purely market-based transactions, there need not be any relationship between the buyer and seller either before or after the sale. Through history, much of international trade has been of the arms-length variety. It is also a trade of product for product, cloth for wine in Ricardo's famous example of comparative advantage in trade between England and Portugal.

The second type of trading relationship is that of the *hierarchical intra-firm* exchange. The advent of transnational corporations (TNCs) led to trade between various units of the same TNC that were set up in different countries. This exchange is not free trade on the market, but a hierarchically decided trade, where price (transfer price) is often determined by the firm itself. TNCs could, for instance, under-price inputs supplied from one country in order to increase margins earned in another country. Such pricing decisions could be dictated by differential tax regimes or TNC strategies. Intra-firm trade within units of the same TNC reflects the disintegration of production across national boundaries, e.g., crude oil may be produced in one country and refined in another. But such intra-firm international transactions do not necessarily represent a disintegration of ownership. While they are not of the classic market variety, they are carried out at the behest of the conglomerate or TNC.

The third type of trading relationship that has evolved in the past 40 years, and the one that we are concerned with in this book is that of contracted sales within a GVC. Unlike the standard TNC, in a GVC, production is vertically disintegrated both geographically and in terms of ownership. The different production units that make up a product's value chain are independent firms, but with highly uneven power relations. 'Supplier firms' lower down the chain and located mostly in low-cost developing countries do not sell their product on the market; rather they undertake contracted production for the 'lead firm,' which is most often located in high wage industrial markets.

In a GVC, the different component and assembly firms are independent firms that are linked by their role as contracted producers who are managed or governed by the lead firm. The lead firm or buyer manages the supply chain, integrates the production segments, and takes the resulting product to the market.

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The disintegration of production segments across firms and even across countries is an extension of the notion of the division of labour which Adam Smith identified within an individual factory, extended across the world. Various tasks are carried out in different GVC segments, e.g., design in one firm, detailed engineering design in another, the manufacture of components in other firms, assembly or final production in another firm, with the highest value tasks such as design, branding and marketing controlled by the lead firm. Different production tasks are thus carried out in different firms located in many different countries, and which together form a GVC.

This splitting up or splintering of manufacture from design, branding and marketing, or even of one part of manufacture (e.g., assembly) from other parts (e.g., component manufacture) is what was characterized (Dicken, 2007) as the specific feature of *globalization* of production, as against the pre-GVC spread of production, which he termed *internationalization*. The WTO video on the manufacture of the Nokia smartphone calls this process that of being ‘Made in the World’.⁴

Where these tasks are carried out, and by what kinds of firms has implications for the kinds of employment relations and capabilities that are fostered in those locations (Grossman and Rossi-Hansberg, 2006). At the level of international trade, what this means is that trade ceases to be trade in products, e.g., cloth for wine, but instead becomes trade in tasks, e.g., cut-make-trim (CMT) for design and marketing. Given that tasks are not whole products in themselves, and have value only when integrated into the production of a final good or service, how these differentially valued tasks are split within a GVC and dispersed across countries has a bearing on how these firms and the countries they are located in are positioned to find ways to move up the value chain—or not.

In this volume, we are concerned with the implications for labour, working conditions and economic development in ‘supplier countries’—places where most GVC-linked firms are suppliers, or non-lead firms. A fair majority of GVC-linked Asian firms, whether in the manufacturing or service industries, generally do not produce and market whole products in the global marketplace. These firms are part of global production networks (GPNs) or GVCs and carry out various tasks for lead firms at the head of these networks as contracted producers. The lead could be major brands, such as Nike or Levi Strauss, big-box retailers, such as Wal-Mart or Tesco, automobile assemblers, such as Toyota or Suzuki (Maruti), or consumer electronics producers, such as Apple and Samsung. The lead firms could also be one that contracts out IT services, or firms that provide tourism services through tour agencies. What is significant is that most of the Asian firms we focus on do not produce and sell directly on the market, but rather do so indirectly as contracted producers.

⁴ See the WTO video ‘Made in the World’ on YouTube.

What are the implications of this GVC structure for labour, employment relations and working conditions in developing countries, such as those in Asia where most supplier firms are concentrated? To unpack this question we explore more deeply the nature of outsourcing relationships and their implications for labour.

1.2 Vertical and horizontal relations

Two issues about the organization of the buyer–supplier relationship within GVCs are likely to have an important bearing on the structure of labour relations within the chain: (i) the distribution of the surplus along the chain and (ii) the business practices of lead firms. The distribution of the surplus is significant because it ultimately makes possible or inhibits certain wage policies and benefits reforms. For instance, if a firm that is part of a GVC earns only a competitive profit, it is unlikely to be able to pay more than a competitive or market wage to its workers; on the other hand, a firm that earns some rent (net revenue above competitive profit) could potentially share a portion of that rent with its workers. Similarly, a lead firm whose business strategy is based on ‘fast fashion’ will have very tight delivery schedules with closely peaked orders, which could push manufacturing firms to manage periods of increased demand not with additional fixed investment, but with mandatory overtime and additional temporary labour.

Thus, both surplus distribution and the business practices of lead firms can affect the labour employment relations of developing country suppliers (Locke, 2013; Anner et al., 2013). Together, these two factors constitute what are called the vertical relations in a GVC.⁵ In the next section, we develop these ideas in greater depth.

1.2.1 Profits and rents or vertical relations

In order to make the analysis simpler, we will assume a stylized GVC model with two segments, one focused on high value activities such as design, branding and marketing, and the other focused on production and manufacturing. The lead firm, the buyer, carries out the design-branding-marketing tasks, while the developing country supplier firm is the manufacturer. Surplus is produced in the GVC, but how is it distributed between the two segments? The distribution of GVC surplus is the result of outcomes in the firms’ respective product markets, i.e., the final product market of the lead firm and the task or GVC segment market of the supplier firm.

The final product is owned and marketed by the lead firm. Therefore, any excess profits or rents that are gained through the sale of the product will accrue to the

⁵ The terms vertical and horizontal relations in GVCs were used in Neilson and Pritchard (2009).

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lead firm. The net gain from trade for the lead firm is the reduction in costs due to outsourcing or contracting out manufacturing tasks to lower cost producers. What the supplier firm receives will depend on the contractual relations and agreements between it and the lead buyer, instead of market relations such as of the consumer-facing lead firm. In an approximate manner, we can assume the cost reduction referred to above as the wage difference between the two countries—the country in which the buyer is based and the supplier country. Questions therefore arise about how the gains due to cost differential are negotiated over and shared between the developed country lead firm and the developing country supplier firms? What factors shape the bargaining power of the supplier?

One factor that can shape a supplier's bargaining power is the complexity of the capability required to perform the outsourced task. The more complex the capability required, the more likely it is that the firm embodying this capability will be able to negotiate a higher share of the gain from trade. But if the capability required is routine and very widely available, then the supplying firm is likely to get less, or even none, of the gain. A very widely available capability or a task, whose performance has low entry barriers, is not likely to get more than the prevailing market price for that service. For instance, there are many countries that can carry out cut-make-trim (CMT) or basic assembly operations in garment manufacture, and so garment manufacturing firms are not likely to get more than the prevailing market price for CMT tasks. However, when there are relatively few firms with the capability to produce IT software, for example, and the high cost of fostering this capability results in high entry barriers, then IT software-producing firms are likely to get a higher price for performing outsourced tasks. Thus, garment and IT processing firms in the same supplier country can exhibit differential bargaining power with respect to their contracts with lead buyers.

The availability of alternative suppliers, itself related to the ease or difficulty of entry, is thus a key factor in bargaining power within a GVC: '... if a firm's bargaining power is an inverse function of the availability of alternatives, then transport equipment producers [who are less numerous] should have more power than garment producers [who are more numerous], and vice versa for buyers' (Mahutga, 2014, p. 163).

It is not only the number of possible substitute producers that counts, however. It is also the number of possible buyers that matter. For example, if there is only one buyer for a particular task, i.e., a monopsony situation, then the seller would be in a weak bargaining position irrespective of complexity of capability. There could also be an oligopsony situation, i.e., only a few possible buyers, such as in the case of a maker of sports shoes, which could curtail suppliers' bargaining power. But, if there are many possible buyers, then the supplier could end up strengthening its

bargaining position. In a contractual relationship, it is therefore the relative numbers of buyers and sellers in a segment market that shape relative bargaining power.⁶

Thus, the factors that influence GVC bargaining power are (1) the difficulty or ease of producing or acquiring the capability required; (2) the number of possible producers of the task; and (3) the number of alternate buyers for the task. Combining the possibility of monopoly and oligopoly positions as buyers and sellers, we distinguish four different combinations of market positions: (1) many lead firms (buyers) and many sellers; (2) few buyers and many sellers; (3) many buyers and few sellers; and (4) few buyers and few sellers.

In the case (1) where there are many lead firms and many suppliers, the suppliers are not likely to get any excess profits or rent from the cost savings from outsourcing. For the buyers, who then have to sell the product to consumers, competition among lead firms is likely to reduce final product prices to their competitive minimum. In this case, there is no rent within the GVC, since cost savings are all transferred or dissipated as consumer surplus. Such a case does actually exist; it is not just a logical possibility. In the Chinese tourism value chain, discussed in this book (Chapter 6 by Yang Fuquan, Yu Yin and Dev Nathan) where there are both large numbers of tour agencies (lead firms) and tourism destination service providers, intense competition for customers has led to the 'zero-fee' tour, where all surplus is dissipated as consumer surplus.

In the case (2), where there are a few lead firms (buyers) and many suppliers, we have monopsony or oligopsony outcomes. The many suppliers will compete among themselves and bring margins down to the competitive minimum of normal profits. All the cost savings accrue as rent to the lead firms. This is the textbook example of a garment GVC, with the brands or retailers taking all the rents, while the CMT producers in, say, Bangladesh or Cambodia, getting only normal profits.

In the case (3), where there are many buyers and few suppliers, the suppliers are likely to be in a stronger bargaining position. The few sellers would be able to capture some, or most, of the benefit of lower costs. But if the number of providers of this service were to increase, then the suppliers' margins would decline. This is seen in the case of software service providers, where Indian IT firms initially had strong bargaining positions. These bargaining positions have become weaker as more firms, including those from developed and other developing countries, have entered the market, with a resultant erosion of margins.

In the case (4), where there are few buyers and few suppliers, both sides could be quite evenly poised in their negotiating positions and bargaining power. The rents would likely then be shared. The supply of IT services to telecom companies is one

⁶ We thank Jennifer Bair for this formulation.

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example of this case, with rents being shared between the telecom companies and the IT service providers. Again, competition among telecom companies could result in rents being passed on as consumer surplus through lower prices.

The discussion of the distribution of the surplus produced in the chain as rents (excess profits) of buyers and competitive profits of suppliers in a GVC and their relative bargaining power has direct relevance for how wage and benefits regimes are shaped among suppliers. We develop this idea more fully next.

1.2.2 Wages or horizontal relations

The distribution of surplus is a key aspect of vertical relations between lead firms and supplier firms in GVCs. (The other aspects of vertical relations are business practices and governance relations which we discuss in subsequent sections). These vertical relations have a key bearing on the horizontal relations between supplier firms and labour in developing (or supplier) countries. In our view, the wage and working condition outcomes constitute horizontal relations in a GVC. They embody the capital–labour relationship that prevails at each node of a GVC. These horizontal relations are not independent of the outcomes of vertical relations in a GVC.

For example, the distribution of surpluses, in the form of competitive profits or rents, does not determine, but does influence wages. Historically, Kalecki (1971) and others have argued that the rent earned by a firm is likely to shape the wage relationship within the firm. Whether the worker is a cleaner, works in marketing or in the design segment, the rent a firm earns is likely to have a skill-differentiated impact on wages down the line. In his theory of wage determination, Kalecki hypothesizes that wages depend on the degree of monopoly or the rent earned by the firm: ‘High mark-ups in existence will encourage strong trade unions to bargain for higher wages since they know that firms can “afford” to pay them’ (Kalecki, 1971, p. 161).

A number of studies support the Kalecki proposition that workers’ wages are positively connected to rents earned by the firms. Mishel (1986) showed that wages in the US are influenced significantly by an employer’s ‘ability to pay’ (Mishel, 1986, p. 91). Unions, he argued, were able to bargain for higher wages in industries that were concentrated and had entry barriers. In a study of Belgian firms, Dobbelaere (2005) argued that workers’ bargaining power and firms’ mark-ups are positively associated. A recent study of Indian wages (Pal and Rathore, 2014) argued that both workers’ power and firms’ mark-ups had declined since liberalization. Therefore, while the presence of unions and labour advocacy institutions is an important source of realizing the link between rents and wages, and unions, at least initially, were in decline after liberalization across Asia, there is empirical support for the link between high mark-ups and higher wage outcomes.

The connection between the firm’s power to earn a high mark-up and demands for higher wages is fairly straightforward. Firms that can procure mark-ups can potentially cover an increase in costs due to higher wages. With mark-up power, they operate in a cost-plus product market. In such a situation, union demands for higher wages are likely to be conceded, since the increase in costs can be passed on to buyers. However, where, firms have to take prices as given, as in a competitive market, covering increases in costs with a price mark-up is less likely. Where industry-level bargaining does not take place, firms in a competitive market would resist increases in wages. Thus, the degree of competition in the GVC suppliers’ market would affect wages in supplier firms within a GVC chain.

There are other factors besides the strength of trade unions that influence wage levels. But the product market outcomes, or vertical GVC relations, set limits to the margins within which local capital–labour relations and other social factors can influence wage outcomes. This is a key point in the analysis in this volume and we will return to it later, particularly in the concluding chapter.

We now turn to the connection between product markets and factor markets and wage outcomes.

1.3 Linking vertical and horizontal relations

The connection between surplus and wages (or, between product and labour markets) can be represented by a 2 × 2 matrix (Table 1.1). Product market outcomes can result in competitive profits [P1] or rents (excess profits) [P2]; and labour market outcomes can include competitive wages [W1] or wages that include a

Table 1.1 GVCs and the distribution of profits and wages

		Profits (Product market)	
		P1	P2
Wages (Labour Market)	W1	A P1, W1 <i>Low profits, low wages</i>	B P2, W1 <i>High Profits/Rents, low wages</i>
	W2	C P1, W2 <i>Low profits, high wages</i>	D P2, W2 <i>High Profits/Rents, high wages</i>

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share of rents [W2]. In what follows we use the two terms rents and high profits interchangeably. The important distinction is between rents as high profits of lead firms and competitive profits of suppliers.

There are four quadrants in the matrix above. The first quadrant, A is characterized by competitive (low) profits and market-rate (low) wages. This could be the situation faced by CMT apparel manufacturers, where there are many competing suppliers, even excess capacity (Milberg and Winkler, 2013), resulting in low or competitive profits. Wages are also low at the prevailing competitive level and may even be below legal minimum wage with a fair degree of outsourcing to informal segments of the value chain.

In quadrant B, the firm(s) can earn some rent or high profits, P2, but wages are competitive, W1. This, one could say, is a situation in which low wages in the face of high rents could trigger the possibility of a strong workers' struggle developing and even being successful in securing a share of rents in the form of a higher wage. This is the type of situation predicted by Kalecki's analysis above. A workers' movement, or even government intervention for that matter, would then shift the firm(s) into quadrant D, where there is some rent for the firm, P2, and some part of this rent is shared with labour, leading to higher than competitive wages, or W2.

Quadrants A and D could together form a GVC. The lead firm would be in D, earning rents and sharing some of that with its workers. The supplier would be in A, with both the firm and its workers earning just competitive profits and wages, respectively.

Finally, we come to quadrant C, where firms earn competitive profits, P1, but wages, W2, are above-market wages. This could be either because legacy wages are high, W2, or the capabilities demanded are complex. With the increasing entry of suppliers into this segment, margins could come down from P2 to P1. It could also be a public sector unit, functioning in a loss-making situation, but able to continue in business by accessing the public exchequer through what Janos Kornai (1986) called the 'soft budget constraint'.

The situations represented in all four quadrants are unstable, in that the firms and workers in these situations all have their own agendas and strategies. Firms have upgrading strategies, such that they might try to move from earning just competitive profits, P1, to earning some rents, P2. Garment manufacturers might try to move from being CMT operators to becoming full-package or FOB suppliers. This, as is argued in Chapter 3 on Bangladesh, is what garment manufacturers in that country did in order to increase their margins. This kind of economic upgrading by garment manufacturers was not in any immediate or automatic sense followed by higher wages, but a series of strikes by Bangladeshi garment workers, along with safety scandals involving factory collapses and fires forced improvements in wage and working conditions over time.