

**New Manufacturing Paradigm, Global Supply Chain
and its Impact on World Trade**

**Delivered by
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as

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Good afternoon, ladies and gentlemen. It is a great honor to address this audience. Today, I would like to address the necessity for a successful conclusion of the Doha Round negotiation on trade liberalization. Over the past years, we have seen discord in Seattle and in Cancun, followed by what appears to be a widening divergence of views between developed and developing economies. The current unsettled state of the world economy makes it all the more urgent that the Doha Round is completed in the remaining months of this year. Among the trade negotiators there now exists a genuinely shared desire to bridge differences and comparatively few outstanding issues remain to successfully conclude Doha. The Paris-based International Chamber of Commerce, a global business organization of which I am Chairman, is taking an active role in promoting this view with the World Trade Organization and with governments round the world.

Slowing economic growth, financial turmoil, and rising food and energy prices are having a damaging effect on business and consumer confidence. A successful

outcome to the Doha Round would send a positive signal that governments can work together to strengthen rules-based global trade, and pave the way for further multilateral action to tackle systemic distortions in world agricultural markets, a big factor behind current high food prices. What is more, modern-day business relies increasingly on growing and complex global supply chains that work best under multilateral rules. I would like to give my own business point of view on what is at stake. In essence, I would like to provide a real world perspective. It is important not to lose sight of what the Doha Round is really trying to achieve.

Since I am asked to speak from the business perspective, allow me to start with something we at Li & Fung deal with on a daily basis – the global production system. Manufacturing today is quite different from the past. In the old days, when we talked about manufacturing a product, the idea that immediately sprang to mind was that everything would be done “in-house” – in one factory, under one roof, and in one country – before a product was exported and sold in another country. But times have changed and manufacturing a product carries a completely different meaning today. Products are no longer manufactured in one factory and under one roof. Increasingly, production is being dispersed across different factories in different countries and indeed, it is becoming globalized.

With respect to the Doha Round, some of you in the audience today may feel that trade in manufactures is not your “number one” priority. What I want to emphasize is that the global production system is of vital interest to all of us. I believe that the multilateral approach to trade regulation is the only way to ensure its continued health, and to promote global prosperity.

The Global Production System

The modern global production system is essential to economic efficiency and consumer welfare. It benefits consumers by improving efficiency and reducing cost. Thanks to the modern global production system, consumers get higher quality, greater variety, and lower prices than they would get otherwise because it is possible to draw from the entire world as a production base. For developed countries, the global production system facilitates the development of the “knowledge economy.” It enables them to focus on design, branding, understanding the needs of consumers, and specialized activities that are knowledge-intensive.

Developing countries also benefit. Today developing countries have far better access to the global economy than was possible in the past. Developing countries can now get into the game, because the global production system allows each activity in the value chain to be placed in the location that is most suitable. It used to be that in order to become active in international trade an economy would ideally have to be able to perform all the activities in the production value chain in one place. This included manufacturing, research, development, branding, and design. Now, because of the global production system, countries can get into the game by performing just one or two pieces of the chain. This is allowing many new locations into the game for the first time. They don’t have to be able to do it all. In this way, the modern global production system lowers the barriers to entry for developing

countries and especially for small and medium size enterprises worldwide. This has obvious implications for employment and economic development.

If you will, allow me to discuss what we do at our company. The Li & Fung Group is a Hong Kong-based multinational company focused on supply chain management, active in export trading, retailing, and distribution. We operate in some 40 countries and regions, and directly employ around 23,000 persons worldwide. Our export trading arm, Li & Fung Limited, sources high-volume and time-sensitive consumer goods on behalf of customers in the world's leading markets. Li & Fung operates through a network of 80 sourcing offices around the world. Taking into account manufacturing contracts with thousands of suppliers, it has been estimated that Li & Fung has indirect employment links with some 2 million workers. Having an open, multilateral trading system is what allows us to help generate business and employment involving so many countries and so many people.

The way we do business at Li & Fung has changed because of the developments I am describing. Let me give you an example. Suppose we have received an order for producing 10,000 shirts from a retailer in the United States. In the old days, our response as a trading company would be to look for the best manufacturer available, give him the order and earn some commission in return. But that model has changed completely. Today, if we get an order for 10,000 shirts, what shall we do? We must first consider the best place to source the yarn required for making those shirts. Having analyzed what is available in the world, we may decide that Korea is the best place to produce that particular type of yarn. We will then

identify a factory in Korea to produce the yarn for us. Next, where should we do the dyeing and the weaving to make the fabric? It depends on the client's need, the timing, the capacity and the technology requirements. Let us say, in this example, we decide that Taiwan is the best place. So we ship the yarn from Korea to, say, two factories in Taiwan because we have a tight deadline to meet. After the fabric is produced, the next thing is to identify the best place to produce the shirts – where to do the CMT, the cut, make and trim – the final stage of adding value to the whole process. For labor, capacity and skill reasons, we may, for instance, want to do it in Thailand. To save time, we may use three different factories in Thailand. So the whole production process is carried out in a dispersed manner across multiple economies.

In the end, the final products that arrive on the retailer's shelf will look exactly the same as if they all come from one single factory, but in fact we have done it in six factories in three different countries. What makes all this possible is of course the development of information technology and modern logistics, which allows us to dissect the entire manufacturing process into different components at different stages. At each stage we will consider the best place to produce the component we need. The end-product, therefore, becomes a truly globalized one. In an open multilateral system, we at Li & Fung can push each order back through our network to the best location for each activity. While this creates obvious gains for consumers, it also enables more locations worldwide to participate and contribute according to their own skills and capabilities, and develop their own competitive strengths.

Dispersed manufacturing is the way of the future. I predict that we will be seeing even more segmentation of the global production system. The underlying reasons are efficiency and economics -- in particular, specialization, division of labor, and gains from trade. The process will be facilitated by improved communications and transportation, and information and management systems that allow the coordination of complex supply systems. As manufacturing activities become more dispersed, there will be benefits to both developed and developing countries. As I mentioned previously, the global production system enables the developed countries to focus on knowledge-intensive activities. It also benefits consumer by improving efficiency and reducing cost.

In the process, developing countries will become increasingly active in the international trading environment. They will be able to do this one step at a time, gradually expanding as they develop their own competitive edge. In this process, small and medium size enterprises also will have the chance to participate in global production, progressively developing their core competences. I see this as a process of democratization of the global production system. With comparative advantage and open trade, there is a place for everyone.

The Multilateral Approach

All of us are familiar with the benefits of the multilateral approach. It is well recognized that overall wealth for individuals and countries will grow when barriers to trade are lifted. The multilateral approach is best because it maximizes this process

of wealth creation. Because the future lies with dispersed manufacturing and increasingly complex trade flows, multilateralism will matter even more in the future than it has in the past.

Going forward, a multilateral world trade system is our very best hope for addressing the broad range of issues on the Doha agenda, such as market access, tariff and non-tariff barriers to trade, trade in services, and trade facilitation. With respect to market access and tariffs, multilateral solutions will help us optimize the efficiency of the complex cross-border flows generated by dispersed manufacturing. Non-tariff barriers become more challenging when production is fragmented, and they have proven particularly thorny to resolve on a bilateral basis. As for trade in services, the single best way to move ahead is for WTO member states in large numbers to come forward with meaningful undertakings to open their services markets under GATS (General Agreement on Trade in Services). The multilateral approach is also best for the various issues in the Doha Round pertaining to “trade facilitation.” These include issues of customs valuation, import licensing, pre-shipment inspection, and rules of origin.

Rules of origin are a good example of why multilateralism matters. Value added is becoming global. Under one widely-accepted, traditional approach, the “country of origin” is where “substantial transformation” occurs, that is, where the inputs are “substantially transformed” into the finished product. In the old days, this approach matched the realities of production. Because everything was manufactured under one roof in one country, the country where “substantial

transformation” occurred and the “country of origin” were one and the same. Today, not all the value added is occurring at the place of substantial transformation. Value added is occurring in multiple countries.

A Proliferation of Bilateral Agreements

Over the past several years, as the Doha Round has faltered, we have seen a proliferation of bilateral agreements in the Asia Pacific and elsewhere. What few people realize is that bilateral agreements have very troublesome consequences for the global production system. Let’s consider a hypothetical example. A bilateral agreement is signed between “Country A” and “Country B.” This bilateral agreement requires that goods have “Country A” as their “country of origin” in order to qualify for duty-free entry into “Country B.” Raw materials can be sourced only from “Country A” and perhaps a few small neighboring economies in order for the finished products to qualify for duty-free entry into “Country B”. The negotiators for “Country B” were very keen to limit the geographic scope of country of origin as much as possible. To my understanding, this example, while hypothetical, accurately reflects real-world bilateral trade negotiations.

Next, let’s try to visualize the consequences of this type of negotiation outcome for the global production system. Returning to the example I discussed earlier, the order for 10,000 shirts, as soon as bilateralism is introduced, everything will be sub-optimized. Bilateralism starts to distort the flows. It throws up barriers. It creates friction, reduces flexibility, raises prices, and hinders the ability of companies

to get new countries involved in the global production system. If you take what I have just said and multiply it by 100, you can see how quickly the global production system degenerates.

I am deeply concerned that the proliferation of bilateral agreements is forcing businesses to sub-optimize. Imagine the situation facing the supply chain manager. You've got thousands of products in tens of countries, and hundreds of factories. In structuring the supply chain, every country of origin and every bilateral has to be tacked on as an additional consideration. With each new bilateral, the considerations relating to "rules of origin" multiply and become more complex. This phenomenon is what trade experts call "the spaghetti bowl effect." Even larger companies have a hard time keeping track. For small firms, it is impossible. That's why the multilateral system is so important. It defines rules of universal application. You need to understand only one guiding set of rules.

From a business standpoint, the question in structuring the supply chain should not be how to qualify for favorable "rule of origin" treatment. Instead, the question should be: "What is the optimal way to create a product?" I should do this in the most cost-effective way for the final consumer. That is the only thing I should be worried about. Why should I worry about where is the point of "substantive transformation"? Why should I worry about it occurring in any particular location in order to qualify for duty-free treatment? The whole world should do it on the basis of economics. In order for the future world trading regime to mirror economic reality

and to allow the use of modern business strategies, what we need is a single, overarching framework for trade.

Conclusion

I stress my commitment to the WTO as the unique forum for global trade rule-making and liberalization, while also recognizing that regional trade agreements have already played a significant role in the global market economy and can play an important role in promoting the liberalization and expansion of trade and in fostering economic cooperation and development.

I wish to emphasize my strong opposition to the creation of an inward-looking trading bloc that would deviate from the pursuit of global free trade. We are determined to pursue free and open trade in the Asia-Pacific region in a manner that will encourage and strengthen trade liberalization in the world as a whole.

Regional trade agreements among APEC countries should not adopt discriminatory measures against other countries, and barriers (to multilateral trade) should not exceed the pre-agreement level.

Regional trade agreements such as the AFTA; APEC; and the '10+3' should pursue to achieve "Open-Regionalism", which will expand from time to time by encouraging other economies to join the system.

In this sense, regional and multilateral trade agreements could be complementary in the pursuit of free trade and economic integration globally only if it adopts the principles of open-regionalism.