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## Social Upgrading in Global Production Networks (GPNs): Institution Role Perspective

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**Abstract:** Global Production Networks (GPNs) may have great impact on regional and national economy and society through their production and distribution effects. Research of social upgrading in GPNs is in fact the synthesis investigation on the welfare of labors who have transformed from economic agents to social agents. We have constructed a framework that includes microeconomic, domestic political, international actors and the power of workers to evaluate the relationships between the external variables and outcome variables (social upgrading). Whether social upgrading is endogenous of economic upgrading or not, improving labor standards, enhancing labor capability and optimizing labor wealth by using relational organizations are the safeguards to implement social upgrading.

**Key words:** Global production networks, social upgrading, the right of labor

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### INTRODUCTION

GPNs are global organizational hubs constituted by functions and operations between enterprises and non-enterprises' institutions. GPNs have blurred the borders among enterprises through developing different kinds of connections of ownerships and non-ownerships; have integrated regional and national economies into GPNs and be influenced by GPNs through different kinds of methods.

GPNs range from large business enterprises and farm, to suppliers and sub-contractors, to household factories; and also involve state governments, multi-organizations, international trade unions and NGOs actors. Part of value added in GPNs must be transferred into low-skilled labor, no matter how little it is (Barrientos *et al.*, 2003). For many workers in developing countries, such as those in garment, footwear and agriculture industries, GPNs are the main sources for creating employment. Most of those jobs are carried out by those women and immigrants who could not find work and provide new income sources for poor families. For example, employment in garment industry has increased from 200 thousands in 1986 to 3 millions in 2010 in Bangladesh and 80% of them are agricultural women who have difficulty finding jobs before (Staritz, 2011).

Although the extension of GPNs can provide developing countries and emerging economies new work opportunities, serious problems exist in employment

conditions, wages, safety and institutional guarantee of casual workers and low skilled labor. Transnational Corporations (TNCs) that organize their productions in GPNs are increasingly reducing contract prices in order to appropriate profit, stifling the profits of export suppliers and the wages of its labors in developing countries. The mode "race to the bottom" eventually damages the welfare of labors that are in the low end of GPNs. Some emerging economies, especially BRICS, are beginning to rethink their neo-liberal policies (deregulation, privatization and exit of state-hold economy), to adjust their existing institutions to regulate production and to provide workers in GPNs social safety and other compensation mechanisms. In Latin-American, countries such as Venezuela, Bolivia, Ecuador, Nicaragua, Argentina and Brazil are pursuing to create an automatic mechanism to replace global free trade and open market mode and to take economic and social development aims into account. Brazil, Chile, Costa Rica and Dominican Republic have revised their labor laws (Piore and Schrank, 2008).

More and more researchers have paid attention to this phenomenon, social upgrading in GPNs. Social upgrading has different explanations, Barrientos *et al.* (2011) define it as the distribution of surplus from industrial upgrading in GPNs; Bernhardt and Milberg (2011) argue that international production provides low-income countries opportunities and challenges to

improve their life level, those kinds of opportunities and challenges are social upgrading. In summary, the measurements of social upgrading are the improvement of employment and wages of low-skilled labor, the improvement of decent work, labor standards, social protection, work conditions and workers' voice and the comprehensive promotion of labors' welfare.

This article will generally conclude social upgrading in GPNs from institutional perspective and will have some enlightenment in resolution of Chinese social problems during its globalization process. The second part has analyzed the mechanism and framework of social upgrading; the third part has explained those assumptions and mechanisms from both international and domestic organizations, politics and trade unions; the last part concludes and illustrates the policy implications.

#### **SOCIAL UPGRADING IN GPNs: A FRAMEWORK AND ROUTE FROM ECONOMIC ANALYSIS TO SOCIAL ANALYSIS**

Many researches in GPNs are generally considering the dynamic changes of interconnectedness of micro agencies in economic structures, seldom paying attention to work processes (Pegler and Knorringa, 2007; Cumbers *et al.*, 2008). In neo-classical economics, labors are assumed to be paid at their marginal cost as endogenous production factors; this assumption does not treat labor as social character. How to fill the gap between labor economic analysis and social analysis; how to integrate workers as production factors (enterprises' focus) and social members (social focus) into GPNs dynamics and how GPNs influence social upgrading through economic upgrading and social institution; these questions are the focus of this section.

**Assumptions of labor: The extension from economic agent to social agent:** Neo-classical economics regards labor as production factor, based on individual firm's maximization of profit and marginal return being equal to marginal cost on labor market, the returns of labor will not be as high as the result of multiplying marginal product by product price. However, as the extension of GPNs and its integration of social and economic relationships into global system, those assumptions may have at least two flaws: Firstly, they have not taken the roles that labor exerts in the context of GPNs into account. As production agent in micro level of GPNs, one main commercial driver of labor is meeting the pressure of cost and the quality standards of production (Barrientos and Kritzing, 2004). Some impacts on the labor intensity and worker skill level imposed by this, the conditions of local labor market

(the availability of different kinds of workers) and the labor quality to meet the standard of buyers have made the determination of wages and welfare of workers more complex and more variable than ever. Secondly, the implications of regarding labor as social agents are increasingly more important, as social agents, labors' welfare state is more and more dependent on their capability and authority (Sen, 2000). The classical theory considers the demands of labor being dependent on the production technology. However, as social agents, the wages and rights of labors which will be influenced by interconnected organizations and government, such as ILO, trade unions and core terms of political rights, are dependent on the negotiation process between bilateral relative strengths and the institutions of labor markets (i.e., minimum wages, negotiation protection from trade unions).

**Analysis of social upgrading route in GPNs:** Probing on how labors' right may be influenced by GPNs calls for the combination of neo-classical economics, institutional economics and international political economics, as well as the focusing on internal and external factors and interactions between them. Figure 1 elaborates the causal process between GPNs and social upgrading. We have constructed a framework that involves micro-economic, domestic political, international actors and workers' right and have assessed the relationships between GPNs variables and social upgrading variables through the mediating effects of different institutional factors. GPNs have dominated global economy and business operations mainly through trade, global production, FDI and TNCs' operation. Global production and FDI can negatively impact labor through vicious competition, lowering profit and race to the bottom and can also positively impact labor through best practice of labor standards, high quality employment and best practice of labor rights. As the figure shows, GPNs create different kinds of pressures, impact negatively and positively on labors' right.

Although global economy can impact directly on domestic social upgrading, domestic and international institutions also exert their roles. What we need to consider is how the extensions of GPNs bring opportunities and challenges to social upgrading mediated by domestic and international institutions. For example, some developing countries' lack of labor collective right or weak trade unions strength is related to its democratic atmosphere, those will influence social upgrading (Mosley and Uno, 2007). At the same time, domestic political variables exerts their mediating roles, for example, collective labor right and export competition

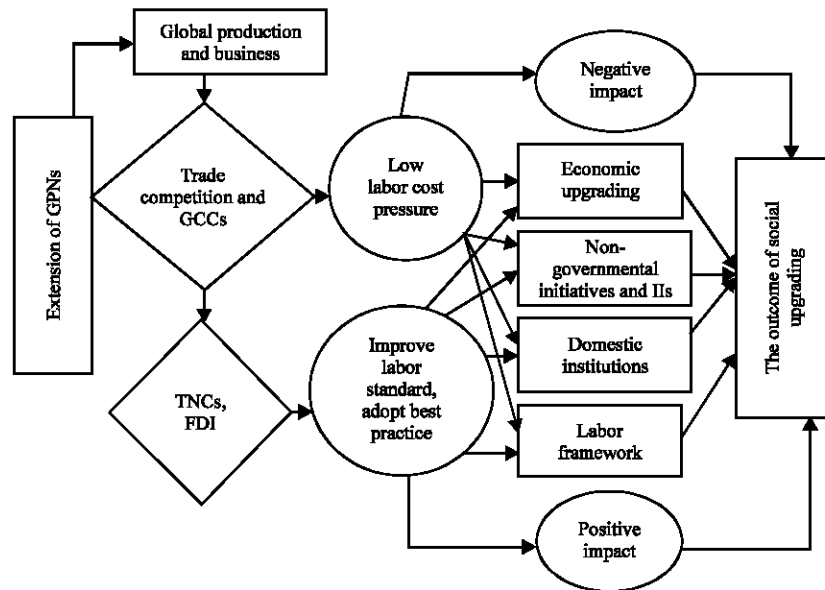


Fig. 1: The route of social upgrading in GPNs

effects are somehow dependent on governmental ideological orientation, international institution and non-governmental forces. This figure has shown the final outcome of social upgrading is mediated by those institutional factors. In the next part we will deal with that problem.

**THE INSTITUTIONAL EXPLANATION OF EVOLUTIONARY ROUTE OF SOCIAL UPGRADING**

**Does economic upgrading lead to social upgrading:** Economic upgrading, generally recognized as industrial upgrading, can be defined as producing better goods or services by producers, producing goods more efficiently or transforming to higher skilled work; most research in economic upgrading has focused on the complexity of production technology and value added (Pietrobelli and Rabellotti, 2006). If we regard increase of productivity (production output changes per worker) as the proxy of economic upgrading and take wage promotion as proxy of social upgrading, neo-classical theory can explain logically the relationships between economic upgrading and social upgrading. Based on marginal analysis theory, wages are the functions of the labors’ marginal output productivity and labor output product prices. This means that as the labor marginal productivity increases, wages will go up (the product prices are supposed to be constant), the rise of labor productivity will lead to rise of wages which means social upgrading is the outcome of economic upgrading.

However, social upgrading is more complex than the assumptions of neo-classical economics. We need to examine other factors other than wages and employment that GPNs create, such as labor standard, social protection, work conditions and the voice of workers. Those factors make the relationships between economic and social upgrading even more complicated (Milberg and Winkler, 2011; Barrientos *et al.*, 2011). There are two main reasons that make economic upgrading difficult to transform into social upgrading: firstly, some developing countries’ work related to GPNs is not high skilled, sub-contracting often involves small scaled production unit and household manufacturing work, exploitative labor practice leads to GPNs down?. Secondly, buying practice of lead firms often asks for low prices and swift delivery of suppliers, this will lead to the temporary employment of many casual workers Those suppliers from developing countries face double pressures of quality improvement and cost reducing, making the employment practices more informal. The relationships between social and economic upgrading are not clear, under what circumstances will economic upgrading lead to social upgrading? And how to balance the relationships between social and economic upgrading? Consequently, only when we adopt those institutional factors that influence social upgrading into our framework, can we better understand the relationships between social and economic upgrading.

**International institutional framework of social upgrading in GPNs**

**Non-governmental initiatives:** Non governmental initiatives refer to code of conduct agreements that

initiated by NGOs, such as industrial groups, business unions and trade unions. Those agreements facilitate market reforms. In the context of GPNs, NGOs establish arrangements with leading firms and supply chains through FDI, production process, contributing to social upgrading. For example, NGOs reach agreements of paying life-pay, agreements of negotiation of wages, voluntary provision of other welfare with firms; provide services for the unemployment and groups of difficult employment. The efforts of non-governmental governance involve from voluntary efforts to CSR along value chains, to identifying social responsibility which created by actives and consumers for ethical economic operations.

The importance of non governmental initiatives comes from the increasing weakness of private regulation and implement mode for workers' protection and safety guarantee (Barrientos and Smith, 2007). Global labor needs a new method of industrial relationship; this challenges the global federation of trade unions (Papadakis, 2008). "International Framework Agreements" proposed by NGOs can provide an efficient way for global suppliers' labor standard. As a sustainable alternative of code, it is based on internationally recognized labor right, rooted in social dialogue, legal labor representatives and collective negotiation procedure. International Framework Agreements facilitate the basic conditions (assurance of Freedom of Association and Collective Bargaining) that can improve decent work in GPNs and become a new channel to improve social upgrading.

**International organization initiatives:** International organizational initiatives have two levels of implications: the first is related to ILO core standards and other standards involved by WTO, World Bank and IMF which improve social upgrading in GPNs. ILO core standards, involve better work programme, ethical trade initiatives, social responsibilities internationalization and human right norms. The second implication is related to agreements that cannot easily reach globally can be implemented bilaterally or regionally (Gereffi and Mayer, 2004). For example, the regional public governance and redistribution form of EU are stronger than those regimes that global governances provide and provide those countries that follow ILO core standards and other standards GSP+ (super trade terms), on the contrary, regional trade agreements, such as NAFTA and CAFTA, involve unilateral agreements of labor and their supplies are limited, not involving ILO core standards. Generally, in the context of increasing fragmentation of trade mode and cross-border buyer in GPNs, the effectiveness of those agreements that globally and regionally improving

labor standards is constrained. One issue that needs continuous research is that identifying which kind of policy can reach decent work? From that point of view, it is important to understand public and private regulation methods, trade agreements roles in improving labor standards. The evolution of GPNs to South-South and regional trade modes, many new issues will turn around? Developing countries and lead firms, the most important of which is that whether conscientious consumers can tolerate labor practice and regulation framework.

### **Domestic institutional perspective of social upgrading in GPNs**

**Strength of trade union and the organizational capability of workers:** Whether the strength of trade unions and the worker organizational capabilities can exert their roles in facilitating social upgrading depend on the following three conditions: Firstly, the relationships between the strength of trade unions and left party. When labor trade unions have intimate relationships with governance party, members of trade unions can protect and improve their existing position, even if under competitive pressures from economic globalization and cross-border production (Murillo, 2005). The problems that this kind of mode can bring are that those countries whose relationships between labor trade union and governance party are intimate will have little chance to emerge into global production; foreign companies will avoid locating in those countries. Those countries whose local government and cross-border capitals jointly suppress local labors can attract more capitals. Assessing the influence of domestic factors' conditions on global productions, independent labor trade unions are central.

Secondly, the trade unions' power and the proposed capabilities of ruling party to enterprises depend on labor market terms and industrial structure. Generally, intensive labor market improve the attractiveness of labor trade unions, the collective power of labors' is high (Rudra, 2002). On the other hand, the negotiation power and labor guarantee will be influenced in relax and high-unemployment rate labor market. In the labor market in developing countries, high-unemployment rate in formal and informal sectors means that firms can draw upon workers from labor market easily and press serving labor. The industrial structure of an economy also matters for workers' organizational capabilities. The workers in agriculture and service sectors are difficult to organize and the employment in manufacturing sectors is easier to organize (Iversen and Wren, 1998). *Ceteris paribus*, workers' collective organization is in low level and the demand in collective labor right is few in the countries that agriculture and service sectors dominate. The

workers in manufacturing and public sectors can request and make full use of collective labor right.

Lastly, different types of labor also influence the organizational and negotiation capabilities of workers. Stolper-Samuelson and H-O models assume that countries affluent of labor export low-skilled labor intensive products, as open policies implement, low-skilled labor can earn higher returns. But in most cases; low-skilled labor cannot prevent their welfare level reducing (Rudra, 2002) and personal income tax increasing (Wibbels and Arce, 2003). For example, the labor-intensive industries mean threshold of access and exit be low, TNCs can easily transfer their production to lower labor cost and relax regulation countries, this makes government and firms face the pressure to keep low wages. Morici and Schulz (2001) have illustrated that those countries dependent on garment export have low protection in worker collective actions. Another problem in low-skilled labor affluent countries is that firms focus more on labors' quality rather than the labors' cost. Lack of high-skilled labors will lead to TNCs transfer their productions to other developing countries or home countries (Arnold, 2006; Surowiecki, 2007). Gallagher (2005) has studied TNCs in Chinese, he points out that some TNCs are interested in reducing total cost, apply sweetshop model; that some others are interested in the growth rate of domestic market of China, as well as trained and highly-motivated high skilled workers.

**Governmental response and the governance of parties:** The government and regulatory sectors of many emerging economies and developing countries, such as Brazil, Chile, Costa Rica and Dominica republic, are focusing on their industrial policies and economic upgrading, at the same time, are enforcing their labor regulation public institutions, the implement situations of their labor law and social safety networks and income transferring mechanisms (Piore and Schrank, 2008). In Bangladash, the social turbulences caused by the low wages and poor work conditions of export factories are so high that the garment buyers join the labor initiatives, press the government to raise the wages of labor, in 2010, the minimum wages in garment factories raised by 80%.

Although the privatization reform of East European countries have weakened the governmental regulations, state-owned enterprises and export-oriented industries, those countries have kept their institutions of labor protection, such as labor inspector, health and safety regulations, labor time, labor law, wage payment and terms of contract, assurance and pension etc. For example, Bulgaria and Slovenia guarantee their labor fundamental conditions through additional support, the legacies of

their socialism institutions have become the main regulators of business (Smith *et al.*, 2008). However, as part of their countries' institutional functions and renaissance, how to measure their labor regulations' efficiency, how to solve the problems that state regulation regimes connected to private code of conduct and how the workers' struggle influence the framework and policies in post-socialism, those questions should be investigated.

Most literature has illustrated that domestic interest and institutions have impacted states' response to globalization (Adsera and Boix, 2002; Basinger and Hallerberg, 2004; Brooks, 2002). Those domestic variables are interacted, complex and long-term. Though open economy can guarantee the whole interest of developing countries, domestic political interest determines the workers' return in globalization, whether workers can earn as much as their employers, whether different sectors can earn the same?. When we investigate the effect of political interest on social upgrading, the primary factor is the ideology orientation of the governance party and the chief administrator. In competitive political regimes, left party and government will protect more their traditional interest: workers' right than right party. Some authors have pointed out that when left party is uncertain about their elections, they tend to reform labor institutions, those reforms can earn the support of working class and tend to protect the collective labor right in the context of trade and open economy (Murillo, 2005; Mosley, 2008).

## CONCLUSION AND FUTURE RESEARCH AGENDA

From the integration of neo-classical economics, institutional economics and international political economics point of view, this article has dealt with how the rights of labor are influenced by GPNs, constructed a framework that involves micro-economic, domestic politics, international actors and the rights of labor and assessed the relationships between external variables (GPNs) and outcome variables (social upgrading). Our conclusions are: (1) Through trade and production globalization, FDI and TNCs' operations, GPNs have dominated the global economy and business operations. This process has positive and negative impacts on the rights of labors by improving labor standards and vicious competition. During this process, the political institutions, organizational institutions, parties and trade unions are exerting their mediating roles and influencing the outcome of social upgrading. (2) According to the marginal analysis theory of neo-classical economics, social upgrading is the inevitable outcome of economic upgrading. However, based on the complexity of social

upgrading, labors as not only economic agents but also social agents who are influenced by different variables, the relationships between social upgrading and economic upgrading need deeper institutional analysis. (3) The occurring and the degree of social upgrading in GPNs depend on the influences of international and domestic institutions. For better work programme, ethical trade initiatives, social responsibility and human rights norm, global and regional organizations can exert their improving roles in social upgrading. Domestic political interests determine the workers' return in GPNs and sectoral gaps, for example, left parties tend to protect workers' benefits in GPNs and the strength of trade union of a country is determined by its industrial structures, endowments of resources, labors' type and export sectors.

Research on social upgrading in GPNs fills the gap between labor economic analysis and labor social analysis. It is a breakthrough that we integrate labor as production factor and social worker into the GPNs' dynamic changes in developing countries. We can generally point out the following as future research agenda: (1) Theoretical combinations of neo-classical economics and institutional economics on labor. Neo-classical economics regards economic and social upgrading as endogenous to economic growth and economic upgrading will lead to social upgrading automatically. Institutional economics argues that there are many norms and regulations that can adjust the relationship between them and not all economic growth can lead to improving social standard. (2) Empirical research on integration of economic growth and social upgrading. In reality, how can economic growth be related to economic upgrading and social upgrading? How to measure those variables? (3) Concrete case study can examine the mediating effects of different kinds of institutions due to the complexity and varieties of the connections of GPNs and national level variables. We can assess the relationships among domestic political and economic regimes, GPNs variables and social upgrading variables; and can generalize the causal relationships among those variables through long-term concrete case study.

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