and analysis has been devoted to understanding GVCs and how they work. This year's special feature provides an overview of some of that recent work, draws on the latest statistics and attempts to provide a link between GVCs and economic theory.

Putting GVCs in Their Place

> *A global value chain describes the full range of activities undertaken to bring a product or service from its conception to its end use and how these activities are distributed over geographic space and across international borders.*[4]

This definition offers a structural view of GVCs, presenting them as a series of activities, performed by any number of firms with each activity located in the jurisdiction where it is most efficiently undertaken. This definition describes how GVCs are organized and why. Another view of GVCs, however, might focus on the transactions they generate; for example, the cross-border flow of intermediate goods and services that are combined in a final product that is sold globally. Both definitions can be reconciled with recent developments in economic theory.

Since the economist David Ricardo expressed his views in 1817, international trade theory has been governed by the notion of "comparative advantage," according to which each participant in trade will specialize in producing the good in which it has comparative advantage. According to Ricardo's model, the meaning of comparative advantage is expressed as a cost advantage, the source of which is not made explicit, although it is generally interpreted and modeled as an advantage based on differences in technology or geography. The result is the well known example of the exchange of British cloth for Portuguese wine. Heckscher and Ohlin built on this foundation, arguing that differences in what they referred to as "factor endowments" determine differences in relative costs. According to the Heckscher-Ohlin (H-O) model, this relationship produces, for example, the result that labour intensive countries should specialize in producing labour-intensive products and capital-intensive countries should focus on capital intensive products.

Both of these classical models recognize that firms and individuals trade, and that differences in technology (Ricardo's model) or endowments (H-O model) are specific to particular locations, i.e. countries. However, under the so-called "new trade theory" developed by Paul Krugman in the 1980s, such differences are no longer the only consideration. According to this theory, even countries that are similar will engage in and benefit from trade providing each specializes and thereby becomes more efficient in production as a result of economies of scale. Again, it is firms or individuals that trade, but the potential gains from specialization are a characteristic of the industry.

Along with economies of scale, geographical proximity is another key element of the new trade theory. Here firms will locate near their customers and their suppliers to reduce transportation costs and gain an advantage over their competitors. Large population centres thus become magnets for production, which is self-perpetuating as firms engaged in upstream and downstream activities follow suit and industrial clusters emerge. But, once again, the differences in transportation costs and the relative importance of being close to suppliers and to customers, i.e. agglomeration effects, are characteristics associated with the industry.

4 Adapted from the definition of global value chains used by GVC Initiative at Duke University http://www.globalvaluechains.org.