SESSION TWO

The Role of International Trade in Structural Transformation

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UN-DESA CDP Capacity-building Workshop on Productive Capacity and the Use of Trade-Related International Support Measures (ISMs) for LDC Graduation

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VISION:
WHY
WHAT
HOW
STRATEGY:
TACTICS:

This Session

1. Discusses the role of international trade in structural transformation based on ingredients of successful develop (WHY)

2. Introduces a systematic methodology for identifying trade development interests and integrating them in a national development strategy (WHY…WHAT)

→→→**THE BOTTOM-LINE.** ***The best vision is a development-centric approach to trade rather than a trade-centric approach to development***

1. International Trade, Structural Transformation and the Ingredients of Successful Development

Evolving Thinking on Ingredients of Successful Development

- **Early development theorists**: Emphasized structural transformation, and in particular industrialization, but with key weaknesses:
  - →Elaborated from closed economies. Focus on import substitution
  - →Ignored the importance of dynamic private sector capabilities to drive the process. "Just set up industries"
  - →Downplayed the importance of macro-economic balances

- **From the 1980s until global financial crisis**: Emphasized global integration. A trade-centric approach to development.
  - →Export-led growth
  - →Increasing export/GDP ratio as a key indicator
  - →Trade liberalization, trade facilitation, trade agreements as key policies
  - →Addressing export supply-side constraints

- **Recent syntheses**: Emphasize structural transformation **with** global integration

Recent Syntheses

- José Antonio Ocampo (2005) Beyond Reforms: Structural Dynamics and Macro-economic Vulnerability
- Commission on Growth and Development (2008) The Growth Report: Strategies for Sustained Growth and Inclusive Development.
- Justin Lin (2012) The Quest for Prosperity: How Developing Economies Can Take Off.
- Michael Spence (2011) The Next Convergence: the Future of Economic Growth in a Multispeed World.
- Joe Studwell (2013) How Asia Works: Success and Failure in the World's Most Dynamic Region.

Basic Features of the Development Process in Successful Countries

- National private enterprises build up production capabilities and international competitiveness in a range of activities undertaken in more advanced countries

- There is a process of structural change in which agriculture and extractive industries decline in relative importance, and manufacturing and modern services increase and production progressively becomes more skill-, technology- and capital-intensive.

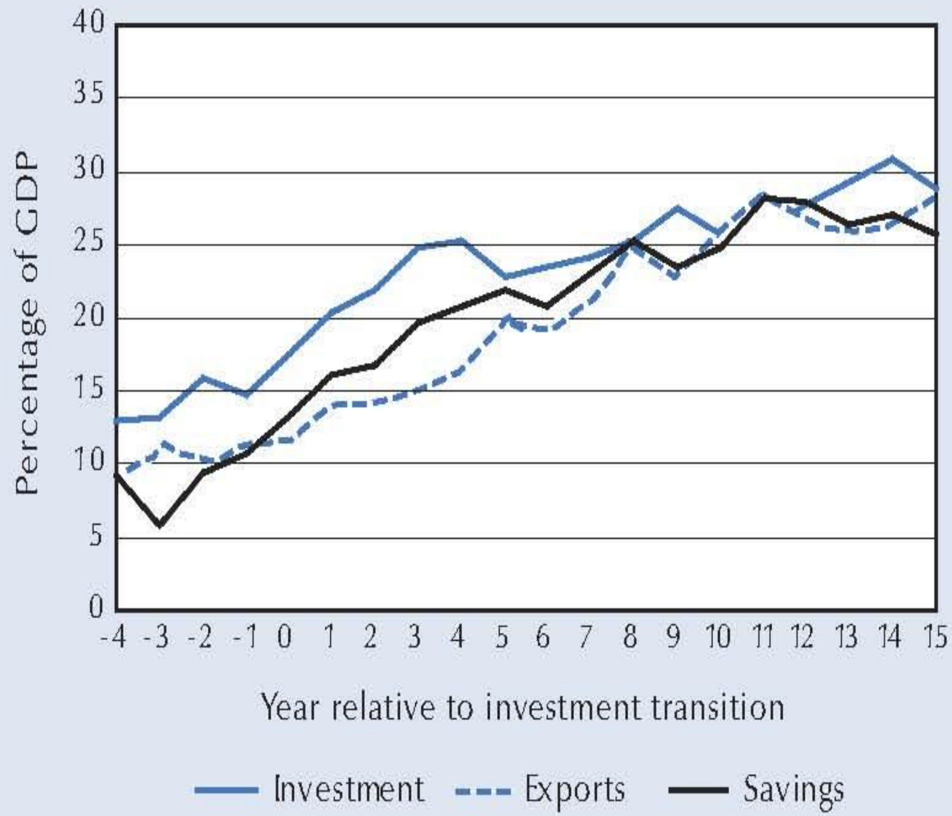
- Structural change and productive upgrading is driven by a rapid pace of capital accumulation and the imitation, adaptation and learning of internationally available technologies and the diffusion of best practices within countries.

→***International trade facilitates this whole process***

How International Trade Matters

- An importance source of demand – underutilized resources and capabilities can be mobilized («vent for surplus»).
- Exports enable imports. Capacity utilization depends critically important imports – fuel, other intermediate inputs and spare parts.
- Investment depends on capital goods imports
- Exports can also facilitate the development of entrepreneurial capabilities through buyer-seller links and competitive pressure
- Capital goods imports are also an important source of technological progress in low-income countries

Chart 34. Investment transition,[a] savings and exports in East Asia



Source: Akyüz and Gore (2001: figure 1).

a Following Rodrik (1999), a country is said to undergo an investment transition at year T if (a) the three-year moving average of its investment rate over an eight-year period starting at T+1 exceeds the five-year average of its investment rate prior to T by 5 percentage points or more, and (b) the post-transition investment rate remains above 10 per cent. Savings are defined as: gross domestic fixed investment plus exports minus imports. The figures are unweighted averages of the following countries and dates of transition year: Indonesia (1969), Republic of Korea (1965) and Thailand (1966). These are derived from Rodrik (1999: table 3.2). The transition year on the graph is year 0.

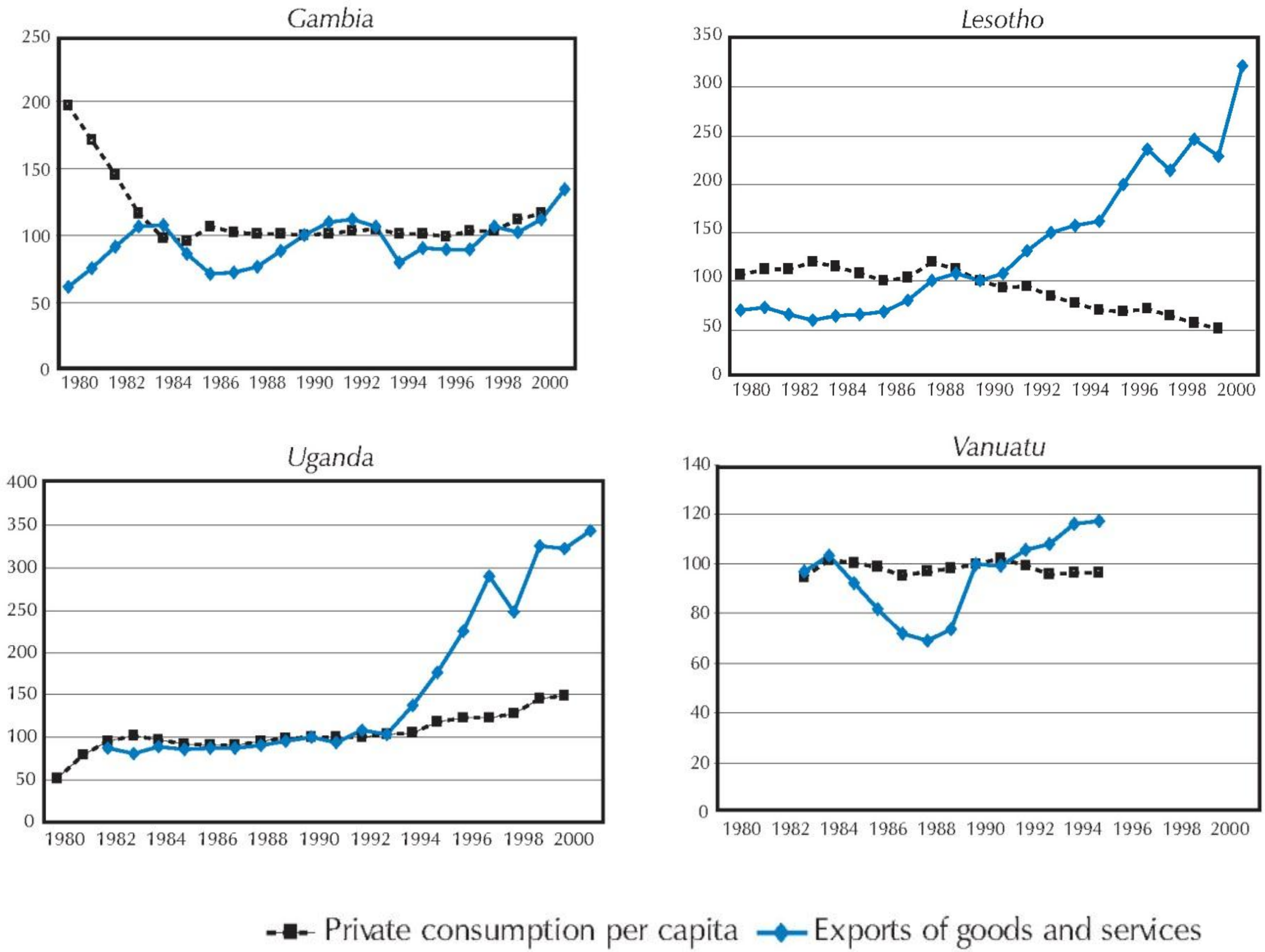
Investment-export nexus

- In building up industrial capacity and competitive strength all newly industrializing economies need to import a large volume of capital and intermediate goods – where investment is growing absolute terms and as a share of GDP imports must also grow faster than GDP.
- An export drive is necessary to overcome the balance of payments constraint (export/GDP ratio up)
- Increased investment and associated technological upgrading reinforces competitive advantage and export growth

→Export composition changes over time. Success comes not only from shifting from primary activities to labour-intensive simple manufactures but also anticipating future difficulties of these industries and nurturing new industries.

Key Trade Challenges of LDCs

- Rapid export growth after deep trade liberalization **BUT**
- Low competitiveness in face of imports so faster import growth
- Continuing marginalization in global economy
- Increasing lock-in to commodities/low skill manufactures
- High levels of export concentration
- Weak linkages to rest of the economy
- High levels of food imports
- Weak relationship between trade and poverty reduction



Gambia
Lesotho
Uganda
Vanuatu
0
50
100
150
200
250
300
350
400
0
20
40
60
80
100
120
140
1980
1982
1984
1986
1988
1990
1992
1994
1996
1998
2000
Private consumption per capita
Exports of goods and services

Why Weak Link Between Trade and Poverty

- There is a positive association between export growth and output growth in LDCs BUT:
  - At any level of export growth, a given export growth rate is associated with slightly lower output growth rate in the LDCs than in other developing countries
  - High population growth rates mean that the rate of export growth is not sufficiently high to enure increasing GDP per capita growth in LDCs for poverty reduction.
  - Real export growth rate of 5% per annum is minimum necessary for poverty reduction.

- There is the potential for a strong investment-export nexus in LDCs because there is a strong relationship between import growth and investment growth. BUT
  - Growth in import capacity in LDCs in the 1990s constrained by falling aid inflows and rising debt service obligations
  - Investment in LDCs not as strongly associated with economic growth as in other developing countries

- Export-led growth is sometimes «enclave-led growth». Weak linkages between narrow export secotrs which are geographically concentrated and the rest of the economy. Examples
  - Export processing zones based on assembly of imported inputs
  - Tourism enclaves supplied imports
  - Capital intensive mines

Example of Rio Tinto in Madagascar

- Ilemenite Mine (titanium dioxide) near Fort Dauphin, Southeastern Madagascar
- Cost: US$585 million – the largest FDI in Madagascar’s history
- Direct employment: 3300 people (88% Malagasy)
- Indirect employment: 1500 people
- Source: ILO employment working Paper No. 58, 2010

The central development challenge in most LDCs is to create sufficient productive jobs and livelihoods for a rapidly growing labour force

- In Mali, the new entrants to the labour force were 171,800 in 2005 and they will increase to a peak of 447,800 per annum in 2045, when the annual additional labour force will start to decline.

- In Madagascar, the new entrants to the labour force in 2005 are estimated as 286,200 and their number will increase to 473,400 per annum by 2035, when the additional labour force will begin to decline.

MOST AFRICAN LDCs ARE EXPERIENCING A BLOCKED STRUCTURAL TRANSITION

- In the past, the major way in which the growing labour force was absorbed was in agriculture (mainly on new land)
- With population growth, agricultural farm sizes are declining and farms are more located on marginal land.
- Mass poverty means that many cannot afford the means for sustainable intensification of agricultural production.
- More and more people are seeking work outside agriculture and urbanization is accelerating.
- Most LDCs have not been able to generate sufficient productive off-farm jobs to absorb the growing labour force seeking work outside agriculture.
- Most find work in survival urban informal activities

Export Expansion and Poverty Reduction: Unsuccessful LDCs

- Rapid trade liberalization with export promotion but weak agricultural development policy
- Job creation in export sectors but this offset by job losses in old import substitution sectors as trade liberalization not calibrated with capabilities of domestic enterprise sector
- Stagnation in agricultural productivity and no positive linkages to non-agricultural sectors
- Rising food imports and vulnerability to food price shocks

Example of Madagsacar (DTIS)

SIMULATION ASSUMPTIONS

- Garment exports grow at 20% p.a. 2000-2003; 10% p.a. 2003-2009
- Tourism service exports grow at 10% p.a. 2000-2009
- Agricultural production grows at 1.5% p.a. 2000-2009
- Domestic industry outside agriculture grows at 2% p.a. 2000-2009

SIMULATION RESULTS

- Proportion of people living below the poverty line will rise from 71% in 1999 to 72% in 2009
- Number of people living below the poverty line will increase by 3.8 million

Export Expansion and Poverty Reduction: Successful LDCs

- Agricultural productivity growth to ensure broad-based rising living standard
- PLUS adequate food supplies to ensure minimum consumption standards for agricultural and non-agricultural population
- Demand linkages to local small-scale industries and services (key to formalization) which provide consumer products to farmers with rising incomes
- Rapid export growth through labour-intensive manufactures (also value-addition to natural resource based exports and services exports?)
- With upgrading of the export composition over time and development of backward linkages (i.e. increased local inputs)

What’s the Bottom-Line?

- Successful development and sustained progress towards and beyond graduation requires a development-centric approach to trade rather than a trade-centric approach to development

2. A Framework for Identifying Trade Development Interests and Mainstreaming Trade in National Development Strategies

Sources for the Methodology

- Based on Least Developed Countries Report 2004 pp.286-292
- Rooted in a critique of how the problem of mainstreaming trade in poverty reduction strategies was being addressed in PRSPs
- Founded on the view that trade development decisions should be related to *the balance of payments constraint* – both exports and imports matter

Some Basic Questions in Identifying Trade Development Interests

1. **What is your basic objective ?**
    - **Freer trade (trade liberalization)**
    - **More trade (increased quantity of trade)**
    - **Better trade (increased quality of trade)**

2. **Does freer trade = more trade = better trade ?**

3. **What is meant by better trade ?**

- **This PPT presents a methodology for identifying trade development interests**

Weaknesses of Trade in PRSPs

- There are two basic ways in which trade enters PRSPs.
  - a) Projections of export and import growth are part of the macroeconomic framework.
  - b) Inclusion of a wide range of trade objectives and trade policies related to those objectives in the text of PRSPs.
- The basic weakness is that there are no links between the trade policy goals and targets and the priority public actions to achieve them.
- The PRSP is also a three-year document showing the policy actions taken over this time horizon and it is not embedded in a longer-term development strategy

Trade Policy Objectives and Instruments in PRSPs

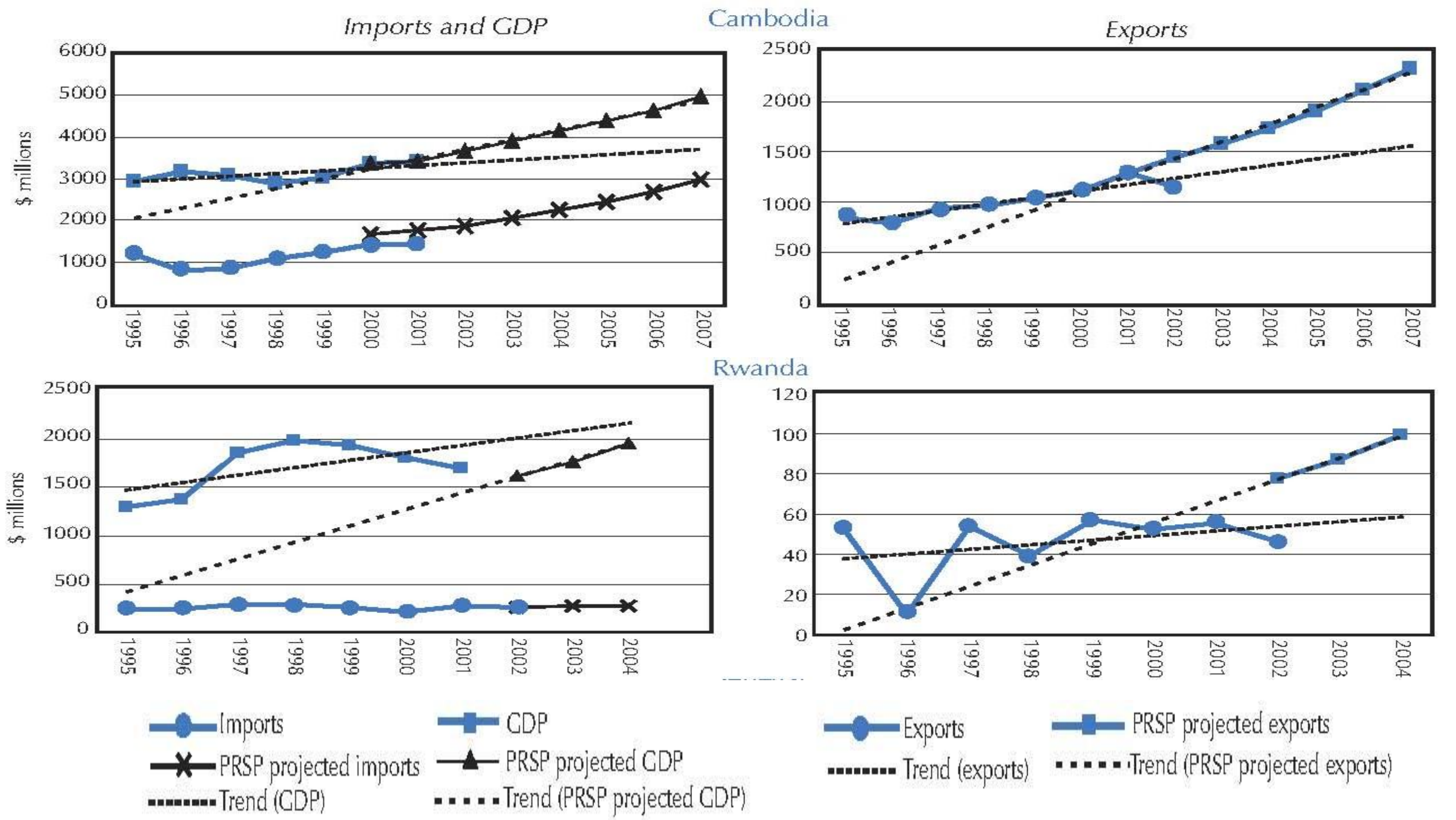
Objectives

- Openness****
- Export diversification
- Increased competitiveness
- Develop high-value agric. exports
- Develop manufactures exports
- Develop tourism
- Trade facilitation
- Strengthen linkages

Instruments

- Exchange rate policy
- Export promotion policies
- Financial incentive schemes for exporters
- Free economic zones and Export processing zones
- Marketing exports abroad (through trade fairs, etc.)
- Commercial diplomacy
- Infant industry protection
- Differential tariffs
- Regional agreements

CHART 42. PAST TRENDS AND PROJECTIONS OF GDP, EXPORTS AND IMPORTS IN THE MACROECONOMIC FRAMEWORK OF SELECTED LDCs
($, million)



Source: UNCTAD secretariat estimates. The projections are the figures contained in the PRSPs, whilst past trends are based on World Bank, *World Development Indicators 2003*, CD-ROM; and on UN COMTRADE from UNCTAD, *Handbook of Statistics 2003*.

Note: The PRSPs' figures for Mali and Senegal were in local currency and were changed into dollars using the estimated exchange rate included in the PRSP of Mali. The PRSP's GDP figure for Rwanda was also in local currency and was changed into dollars using the exchange rate for 2002 of 511.85, taken from IMF, *International Financial Statistics 2003*, CD-ROM. All data are in current dollars.

Common (but questionable) assumptions in the PRSP macro-economic trade forecasts

- **It is expected that GDP growth will be higher than in the recent past.**
- **It is expected that export growth will be higher than the recent past.**
- **A major part of the increase in GDP is expected to come from export expansion**
- **It is expected that import growth will be lower than the recent past.**
- **It is sometimes expected that import growth will be slower than GDP growth.**

- BUT HOW? What is the relationship between the instruments and these expected outcomes?

An Alternative Methodology

- Step One: Identify broad trade development interests within the context of the national development strategy
- Step Two: Identify and compare different trade policy options which support these interests (WHAT)
  - **Focus on the balance of payments**
  - **Estimate the external trade requirements for achieving growth, employment and poverty reduction goals**

Step ONE: National Development Strategy

A development strategy includes:

- **A long-term vision of national development objectives**
- **Strategic elements required to achieve those objectives and their sequencing, including trade development**
- **Policy measures and process required to achieve objectives**

Alternative Development Strategies

- **Import substitution industrialization**
- **Openness as a development strategy (liberalization)**
- **Export-led growth**
- **Export-led growth with a human face**
- **Open development strategies in which exports are important but there is more balance between domestic demand and export expansion in the growth process**

Alternative Open Development Strategies which Seek Adequate Export Growth

- **A balanced growth strategy based on agricultural productivity growth and export-accelerated industrialization (variants of East Asian model);**
- **An agricultural-development-led industrialization (ADLI) strategy – which includes infrastructure investment and technological progress in agriculture together with forward linkages into processing activities – with an export component;**
- **Development and diversification through management of mineral revenues.**
- **Tourism development with thickening local linkages**

The development strategy needs to be chosen in relation to, and adapted for, country circumstances.

NB: The role of trade is different in these different development strategies.

For more details see LDC Report 2004, Annex to chapter 7, pp.308-311.

STEP TWO: Identify Trade Policy Options

1. **Set a poverty reduction or employment target and estimate the growth rate required to achieve the target (this depends on elasticity of poverty reduction, or employment increase, with economic growth)**

2. **Make future projections of trade balance - future import growth on the basis of price and income elasticities of demand for imports; future export growth on the basis of trends in export volume and export unit values.**
3. **Identify alternative trade policy options for increasing the income elasticity of demand for exports and decreasing the income elasticity of demand for imports.**

4. **Evaluate trade policy options according to their growth, employment and poverty reduction effects**

Possible Questions to Ask in Identifying Trade Policy Options

Exports

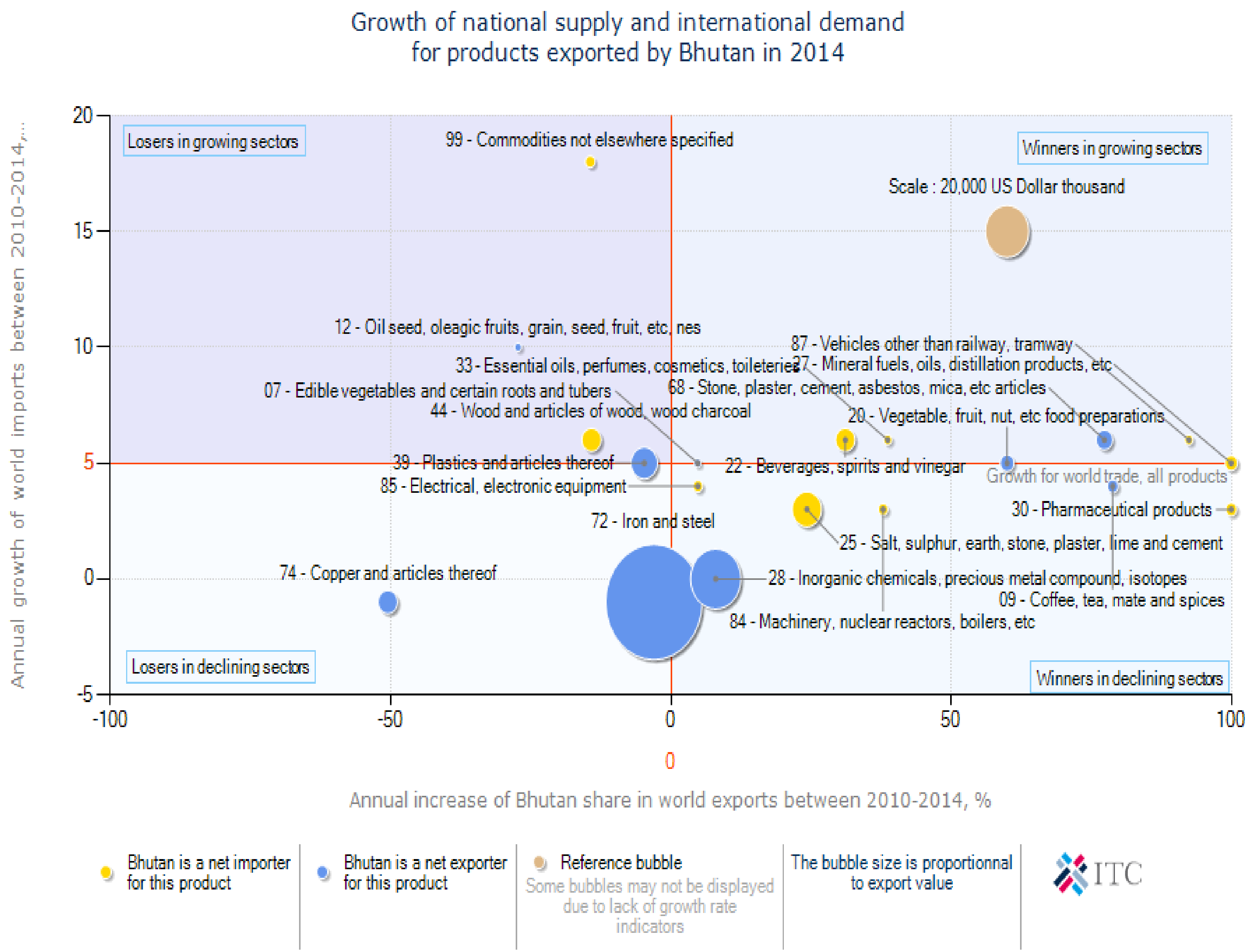
- What are a country's major traditional exports? (major products in the recent past)
- What are the demand growth prospects of a country's major traditional exports?
- To what extent is it possible to increase the income elasticity of demand for exports through improved competitiveness of traditional exports (increase in global market share)?
- What new products and sectors can be promoted to increase the income elasticity of demand of exports (change export composition towards more dynamic products)?
- What new markets can be accessed in order to increase the income elasticity of demand for exports (change geographical destinations of exports)?
- Are there untapped opportunities for South-South trade?
- How can the instability of export growth be decreased?

Imports

- Are there opportunities for efficient import substitution, including backward linkages from export activities?
- Are bound tariffs higher than actual tariffs enabling time-bound increase in import tariffs in specific sectors?
- Are there opportunities to reduce import costs through better import procurement practices?
- How is it possible to make the best use of the untying of aid?
- Can cost savings be achieved through regional import substitution?

ITC Trade Map: Bhutan Product Exports 2010-2014

Code	Product label	Trade Indicators						
		Exported value 2014 (USD thousand)	Trade balance 2014 (USD thousand)	Annual growth in value between 2010-2014 (%, p.a.)	Annual growth in value between 2013-2014 (%, p.a.)	Annual growth of world imports between 2010-2014 (%, p.a.)	Share in world exports (%)	Ranking in world exports
TOTAL	All products	170,865	-94,331	-5	11	5	0	179
'72	Iron and steel	109,224	81,206	-4	-2	-1	0	83
'28	Inorganic chemicals, precious metal compound, isotopes	27,616	27,413	8	23	0	0	87
'25	Salt, sulphur, earth, stone, plaster, lime and cement	8,235	-1,930	28	2006	3	0	122
'39	Plastics and articles thereof	6,974	3,861	0	47	5	0	126
'44	Wood and articles of wood, wood charcoal	3,425	-5,797	-9	25	6	0	130



Growth of national supply and international demand
for products exported by Bhutan in 2014
Losers in growing sectors
Winners in growing sectors
Losers in declining sectors
Winners in declining sectors
Scale : 20,000 US Dollar thousand
99 - Commodities not elsewhere specified
12 - Oil seed, oleagic fruits, grain, seed, fruit, etc, nes
33 - Essential oils, perfumes, cosmetics, toileteries
07 - Edible vegetables and certain roots and tubers
44 - Wood and articles of wood, wood charcoal
39 - Plastics and articles thereof
85 - Electrical, electronic equipment
72 - Iron and steel
74 - Copper and articles thereof
87 - Vehicles other than railway, tramway
27 - Mineral fuels, oils, distillation products, etc
68 - Stone, plaster, cement, asbestos, mica, etc articles
20 - Vegetable, fruit, nut, etc food preparations
22 - Beverages, spirits and vinegar
Growth for world trade, all products
30 - Pharmaceutical products
25 - Salt, sulphur, earth, stone, plaster, lime and cement
28 - Inorganic chemicals, precious metal compound, isotopes
09 - Coffee, tea, mate and spices
84 - Machinery, nuclear reactors, boilers, etc
Annual growth of world imports between 2010-2014,...
Annual increase of Bhutan share in world exports between 2010-2014, %
20
15
10
5
0
-5
-100
-50
0
50
100
0
Bhutan is a net importer for this product
Bhutan is a net exporter for this product
Reference bubble
Some bubbles may not be displayed due to lack of growth rate indicators
The bubble size is proportionnal to export value
ITC

Importance of Service Exports

Commercial service export share in total exports 2011

- Vanuatu 44%
- Gambia 38%
- Nepal 30%
- Uganda 27%
- Timor Leste 27%
- Solomon Islands 19%

Source: ITC 2013 LDC Service Exports

Possible Questions to Ask in Assessing the Growth, Employment and Poverty Reduction Effects of Different Trade Policy Options

- **In what products and sectors does the country have a comparative advantage?**
- **What are the demand growth prospects of different products and sectors in world markets?**
- **What is the magnitude of local value-added, externalities and potential for learning associated with these products and sectors?**
- **What is the employment intensity of specific export activities and their linkages with the rest of the economy?**

But the overarching issue is:

How do the different trade policy options relate to the overall development strategy?

Thank you