Summary Outcome Document

Sub-regional Workshop

Fostering Structural Transformation and Export Diversification in Selected Asian Landlocked Developing Countries

16-17 October 2018
Ulaanbaatar, Mongolia
Background:

The group of Landlocked Developing Countries (LLDCs) has seen impressive growth rates exceeding 7% on average between 2000 and 2013. However, a subsequent sharp slowdown of growth down to 2.6% in 2016 (0.4% in per capita terms) revealed their persistent vulnerabilities resulting from heavy commodity dependence or lack of economic diversification. While previous windfall gains from commodities exports allowed the LLDCs to make some progress towards achieving poverty reduction objectives through investments and social programs, the slowdown also affected the rate of poverty reduction. Even during the previous period of high growth, the pace of poverty reduction was below what could be expected.

The reason for the skewed performance of LLDCs, in addition to their geographical challenges, is their high dependence on commodities – 26 out of the 32 LLDCs depend on primary commodities for more than 60% of their exports. This means that growth is highly concentrated in a sector that is not very labour-intensive (such as capital-intensive extractive sectors), and the gains of growth are neither automatically, nor broadly shared. Furthermore, growth is highly vulnerable to external shocks, such as changes in world prices of commodities. Overcoming commodity dependence requires achieving structural economic transformation, from traditional, low productivity sectors towards higher productivity sectors, and diversifying exports away from primary commodities.

For this reason, there is an urgent need to foster productive capacities, diversification and structural transformation as basis for ensuring inclusive and sustained development. LLDCs also need to invest in transport infrastructure and trade logistics, including by promoting public private partnerships (PPP), regional cooperation, and securing strategic support from development partners.

Summary:

Against this background, UNCTAD, with the support of the Common Fund for Commodities, has undertaken a comprehensive study on export diversification in selected Asian LLDCs, including a mapping of potential export markets. With the objective of sharing the findings and conclusions of the study, UNCTAD and the International Think Tank for LLDCs organized a sub-regional workshop to identify the most pressing trade and development challenges facing LLDCs in the Asian sub-region, and to build consensus on policies and strategies needed to address these challenges.

At the workshop, participants also reviewed the performance of Asian LLDCs with regard to fostering productive capacities and structural transformation. It was noted that LLDCs as a whole had only made limited progress towards building productive capacities, and achieving structural transformation and economic diversification. The share of the manufacturing sector in LLDCs has remained broadly constant since the year 2000, and there has been no improvement in the diversification index (measuring the degree to which the export structure of LLDCs differs from the global average).

The same lack of progress can be observed in Asian LLDCs, whose level of export concentration has remained at the high average of 0.4 throughout the same period. Indeed, within Asian LLDCs, countries like Turkmenistan and Kazakhstan have some of the highest degrees of export concentration, with their index measuring 0.7 and 0.5, respectively. A similar
picture arises with regard to the diversification index, where the level for the LLDCs as a group has remained broadly constant at 0.63, while the level for Asian LLDCs continues to be at 0.75, with a small rising trend. Considering the share of manufacturing value added in total GDP, it was noted that the manufacturing sector in Asian LLDCs, on average, accounts for a higher share of GDP than in LLDCs (about 13.5% in 2016), but has been on a declining trend since 2000, when it stood at 16%.

The participants noted that the low performance of LLDCs in terms of structural transformation is partly explained by the confluence of weak productive capacities and their geographical disadvantages, which make it more difficult to achieve their socioeconomic development objectives. Their high trade costs render the import of manufacturing inputs expensive, and make manufactured exports uncompetitive, especially compared to lucrative commodities exports.

In order to overcome this obstacle, the workshop discussed some of the main opportunities and challenges faced by Central Asian LLDCs in building productive capacities and achieving export diversification and structural transformation. In particular, the workshop examined the cases of four Asian energy (electricity)-exporting LLDCs: Bhutan, Kazakhstan, Mongolia and Turkmenistan. It was noted that several of these LLDCs have the potential to develop a number of new export sectors as part of their drive for economic diversification. In the case of Bhutan, the tourism and the ICT sectors have shown potential for diversification. In Kazakhstan and Mongolia, agribusiness and tourism have been identified as higher-productivity-growth sectors with export potential. In Kazakhstan, light manufacturing, cereals and tourism could also be considered. Finally, in Turkmenistan, the textiles sector, tourism and agriculture hold diversification potential.

The workshop identified the policies and measures needed to promote these and other strategic sectors in each country. The measures suggested ranged from specific sector or company-specific incentive measures to general policies to support education and skills, fostering an enabling environment for the private sector, and building trade logistics and transport infrastructure.

The workshop also introduced UNCTAD’s Productive Capacities Index and assessed the performance of Asian LLDCs in building productive capacities using this new tool. Participants greatly appreciated the Productive Capacities Index, and noted that it could serve as a useful tool to formulate and implement productive capacity centered policies and strategies. It can also facilitate the sharing of experiences, lessons learnt and best practices among Asian LLDCs in fostering productive capacities and structural transformation, as well as export diversification.

The outcome of the sub-regional workshop, particularly the recommendations contained therein, will feed into the Asian regional, as well as the global Mid-term Review of the Implementation of the Vienna Programme of Action for the LLDCs for the Decade 2014-2024.

**Key recommendations:**

Landlocked developing countries (LLDCs), in preparation for the Mid-term Review of the Implementation of the Vienna Programme of Action due to be held in 2019, and in the context of their domestic development policies and strategies, are advised to put due emphasis on building productive capacities and promoting structural economic transformation. In order to
foster productive capacities and structural transformation as well as export diversification, LLDCs should give consideration to the following set of policies and measures:

1. It is important for Asian LLDCs to enhance the enabling environment at all levels to foster productive capacities and structural economic transformation for inclusive and sustainable development. Productive capacities are the productive resources, entrepreneurial capabilities and production linkages which together determine a country’s capacity to produce and export goods and services, and enable it to grow and develop. To this end, micro and macroeconomic, industrial, rural and infrastructure policies should be geared towards the development of productive capacities and maintenance and utilization of existing capacities.

2. Fostering productive capacities and structural transformation also requires putting in place macroeconomic policies consistent with the objective of production transformation. It needs a strategic approach to foreign direct investment (FDI), which should be complementary to but should not be promoted at the expense of domestic investment. LLDCs should also pay attention to the level (quantity), rate and quality of investment, as well as its sectoral distribution. Regional cooperation can play a vital role in developing infrastructure needed for productive transformation in LLDCs.

3. Several Asian LLDCs have huge potential in export diversification, especially in agriculture and agro-processing, textiles and clothing, leather and leather products, tourism, light manufacturing, as well as great scope for vertical diversification within existing export baskets, especially in the extractive sectors. Tapping into this potential requires enabling macro and microeconomic policies, as well as coherent trade, investment and industrial policies with diversification strategies in export-oriented labor-intensive manufactures. LLDCs need also make continued efforts to take advantage of the potential existing in the regional markets, which are less demanding in terms of quality and technical standards.

4. To fully tap the existing potential for diversification in LLDCs, it is important to pursue sector-specific strategies:

   a) **For the agriculture sector**, it is essential to put in place multi-pronged approaches with a particular focus of agricultural policies on raising output, while at the same time increasing the value-added of agricultural products; promote modern production techniques and technologies (e.g. the use of herbicides and fertilizers), including through the intensification of production to improve both quality and profitability; fostering the growth of private input suppliers; expanding extension and advisory services; and enhancing research and development (R&D) activities in areas demanded by farmers. LLDCs in the Asian region, with a potential for agro-processing also need to introduce a quality-grading system to incentivize farmers to improve product quality and inform producers about safety and quality standards abroad.

   b) **For light manufacturing**, it is important to put in place supportive, complementary and coherent trade, investment and industrial policies and strategies in sectors of comparative advantages. Foreign direct investment is important for bringing not only capital and technology, but intangible assists
such as knowledge and modern managerial skills. Policies are also needed to support the participation of businesses in global value chains (GVCs).

c) **For the tourism sector.** Asian LLDCs need to emulate successful tourism development strategies in other developing countries, including undertaking additional marketing efforts in home countries, reducing costs and improving the quality of services, improving the quality of transport infrastructure (road, rail, and air), and facilitating local supply sourcing. In addition, promoting linkages between the tourism sector and local suppliers, as well as identifying and addressing bureaucratic requirements for tourists are key for helping LLDCs tap into the potential of tourism for their socioeconomic development. Furthermore, LLDCs need to consider the ways and means to accelerate skills development for qualified tourism professionals, for example by offering training programs for interpreters and tour guides.

5. It is important to build the foundations for skills and knowledge-based economies to improve the competitiveness of Asian LLDCs. In this context, technical, vocational education and training programmes need to be realigned with the needs of the economy and the requirements (demands) of the private sector. LLDCs need to put in place mechanisms to address skills mismatches by improving the quality of education and by ensuring skills and knowledge offered in the education system are aligned with the needs of the economy. It is important to provide more training opportunities and improve access to vocational education; improve skills standards and verification mechanisms; revise the incentive pay structure for teachers, ensure that employers have a voice in developing course offerings and curricula, and consider the greater utilization of private-public partnerships (PPPs) in education to augment the quality and cost-effectiveness.

6. Fostering industrialization and technological upgrading are critical for building productive capacities and accelerating structural transformation. The experiences of current developed countries, advanced developing countries or emerging economies indicate that governments have an important role to play in inducing industrialization and structural economic transformation. Therefore, it is crucial for LLDC governments to take a more proactive and catalytic stance to stimulate productive activities, including through creating enabling environments for business and investments (domestic and foreign direct investment). However, it is important to pay particular attention that industrialization should not be pursued at the expense of other sectors such as agriculture and services. Rather, they should be promoted in a mutually supportive manner, facilitating backward and forward linkages, especially between agriculture and the industrial sectors.

7. In recognition of the contribution of the private sector to economic growth and poverty reduction, governments of LLDCs need to encourage private sector development through enhancing private sector capabilities as well as improving governance and business regulations. In addition to facilitating access to finance and easing ways to conduct business, it is instrumental that LLDCs support the development of domestic entrepreneurial capabilities. To that end, LLDC governments are encouraged to take measures across the board to strengthen infrastructure – from enhancing road and information and communications technology (ICT) networks to ensuring greater access
to credit and reducing the cost of trade finance. In doing so, they need to attract investments into new projects, as well as into the upgrading and maintenance of already existing infrastructure. It is also important to provide targeted incentives to carefully selected sectors and firms with potential for employment generation and diversification. However, governments need effective policies to strike the right balance between compulsions and incentives.

8. LLDCs that have natural resources need to devise a mechanism for saving excess revenues from natural resource extraction during commodities booms, such as through the creation of a Sovereign Wealth Fund, to save windfall profits and contain the “Dutch Disease.” It is equally important to pursue pragmatic and countercyclical fiscal policies, smoothing out fiscal expenditures over time. One possibility is to limit expansion of social spending and the increase of public sector wages within non-expansionary levels, to be able to maintain it when windfall profits decline. LLDC governments are encouraged to continue to improve tax collection through tax reforms including by simplifying the tax system and rationalizing incentives.

9. Asian LLDCs need to identify regional or global value chains in the sectors where they have comparative and competitive advantages. Business and trade facilitation measures including modernizing customs clearance procedures, trade logistics and infrastructure (soft and hard) are key for successful diversification. Public Private Partnerships (PPPs) in the provision of trade services and logistics can enhance diversification prospects.

10. Beyond improving transit transport and trade facilitation objectives, regional cooperation provides important avenues for Asian LLDCs to harmonize and coordinate policies to build their productive bases, accelerate structural transformation and enhance their socio-economic development. Therefore, particular attention should be paid to a development-led approach to regional integration which requires not only a coordinated set of policies to collectively address structural vulnerabilities, but also a greater provision of regional public goods: hard and soft infrastructure, energy, and telecommunications networks. In this context, regional development banks are particularly suitable to finance key investments in regional public goods.

11. Advanced developing countries and transit neighbors, including in the context of South-South cooperation and regional economic integration can support the efforts of the LLDCs by:
   (i) Sharing relevant policy lessons from their successful experiences;
   (ii) Facilitating technology transfer and innovation;
   (iii) Providing additional resources for the development of productive capacities; and
   (iv) Providing market access to the exports of LLDCs, in a way that fosters learning and enhances their participation in regional commodity value chains.

12. In view of the increasing importance of the commodities sector, LLDCs should strive to define long-term visions that link the commodities sector with national development strategies. By ensuring that the role of commodities is incorporated into national development strategies, LLDCs increase the likelihood of maximizing the potential of the sector in order to avoid a repeat of the jobless growth without structural transformation experienced during the previous decade. A more holistic approach that
incorporates a development perspective and that takes into account the role and functions of commodities in economic growth and poverty reduction is required.

13. Trade facilitation and transport infrastructure, including maintenance and the modernization of existing trade routes requires increased public investment, which in turn requires the increased allocation of financial resources from external sources, especially given the paucity of investible resources in most LLDCs. Particularly, investment in modern information and communications technologies (ICTs) can bring quick results and effective solutions to facilitate trade and improve LLDCs’ integration to the global market. Donor financing, including from international financial institutions, will be crucial in expanding and upgrading the Automated System of Customs Data (ASYCUDA) and other systems that can be of paramount importance in addressing the key challenges facing LLDCs. Further measures can include streamlining the customs procedures by reducing the number of documents required for exporting/importing and harmonizing them with international standards as key to reduce trade cost and improve export competitiveness of LLDCs.

14. LLDC on their part, need to establish a transparent and competitive tendering process for road projects, and strengthen the capacity of the agencies in charge of assessing new infrastructure projects. They also need to strengthen the regulatory framework for effective oversight of road networks and flight operations, as well as airfield regulations, and provide more staff training and enhance skills upgrading.

15. A number of Asian LLDCs have huge capacities in electricity generation. It is critically important to use this potential to enhance productive capacities and structural economic transformation. It is equally crucial to increase investment in upgrading and maintaining electricity infrastructure (both power plans and distribution network). LLDCs should further encourage more private sector participation (such as PPPs and FDI) in both the construction of new facilities and the rehabilitation of old facilities. Moreover, they should lower the cost of establishing an electricity connection and simplify the related procedures. Finally, LLDCs should consider promoting the development of renewable energy, including solar and wind power.