Aid for Trade at a Glance 2019

Economic Diversification: Lessons from Practice

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OUTLINE OF THE CHAPTER

1. Why economic diversification matters?

2. Routes towards economic diversification

3. Policies to support economic diversification
   - Appropriate incentive frameworks
   - Lowering trade costs
   - Support to market, policy, and institutional failures
   - Facilitating adjustment and the reallocation of resources

4. Drivers of successful diversification efforts

1

Why economic diversification matters?

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Moving labour from low productivity to higher productivity jobs is imperative for sustained growth

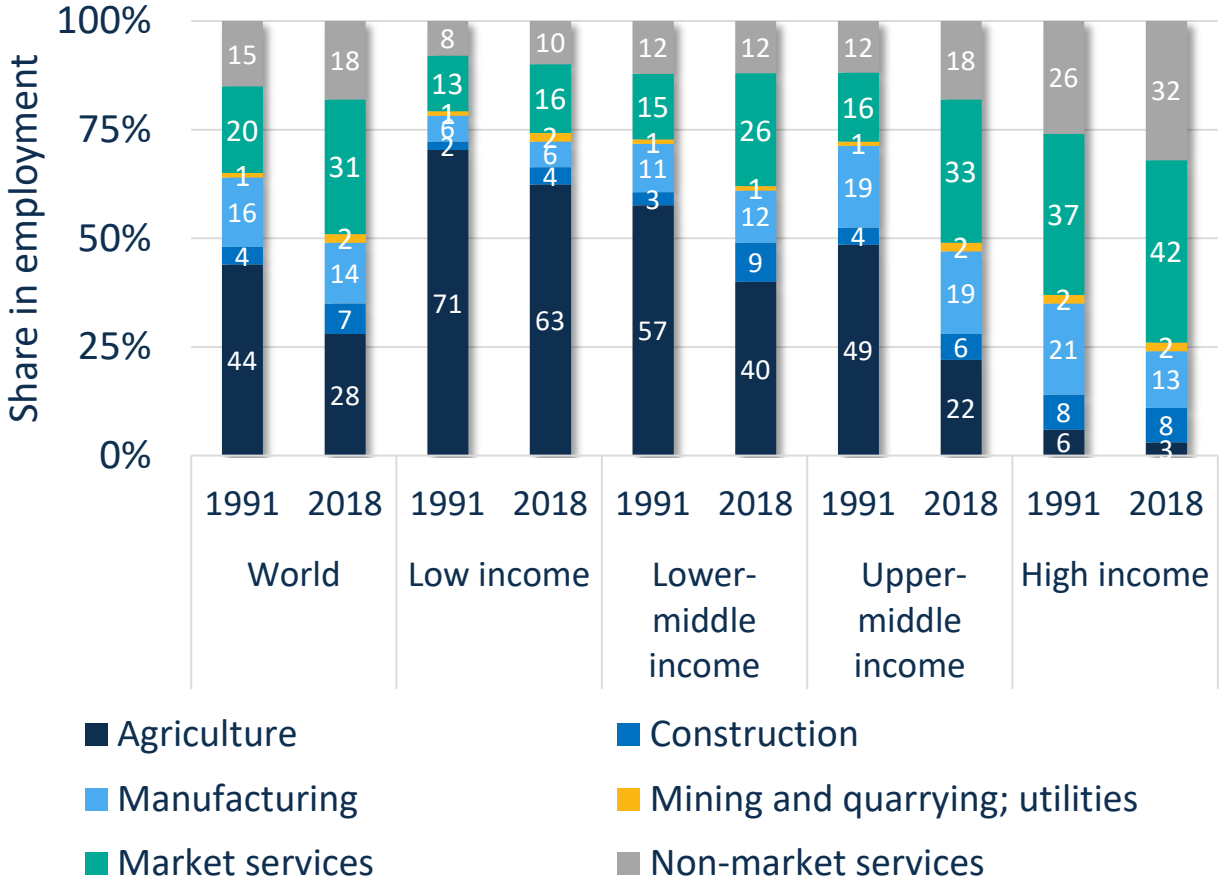
Less vulnerability to external shocks (e.g. weather, world prices).

Growth is often unbalanced in mineral commodity—dependent economies and more difficult to sustain in agrarian ones.

Rapidly increasing working populations in developing countries necessitate economic diversification and job-producing private sector growth.

New technologies and automation present challenges as well as opportunities (e.g. reshoring versus "servicification").

Most employment expansion has occurred in services



Source: ILO (2019).

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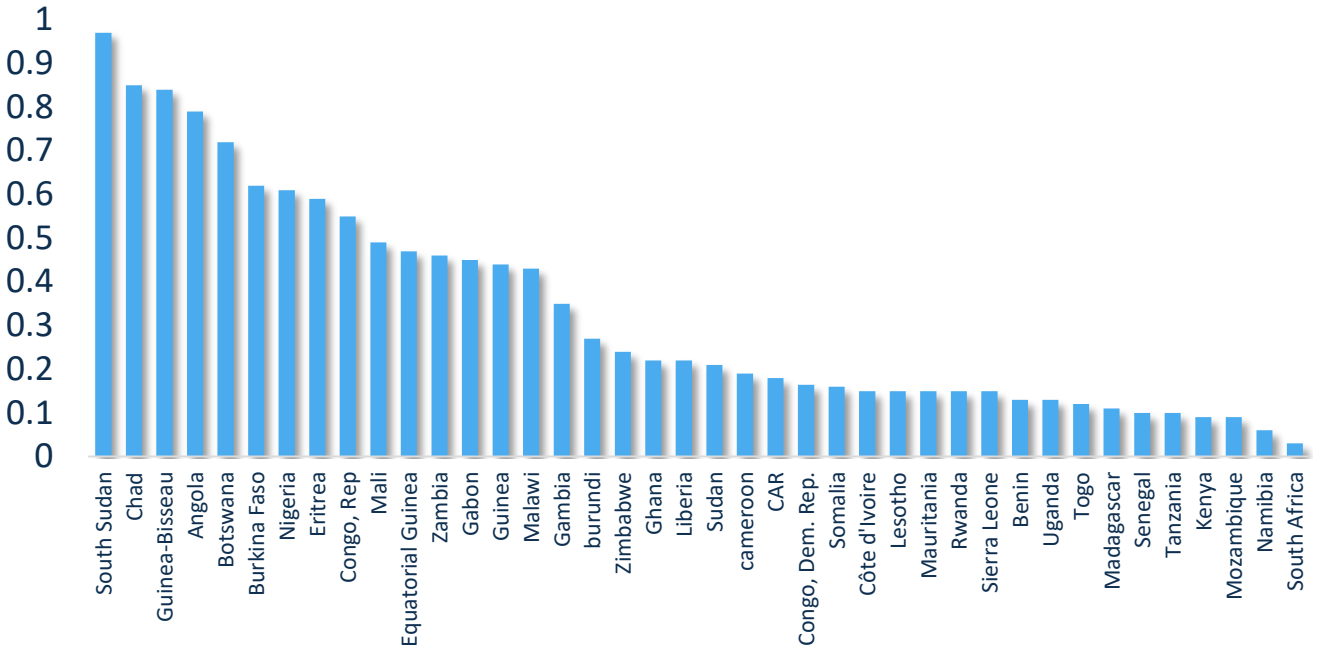
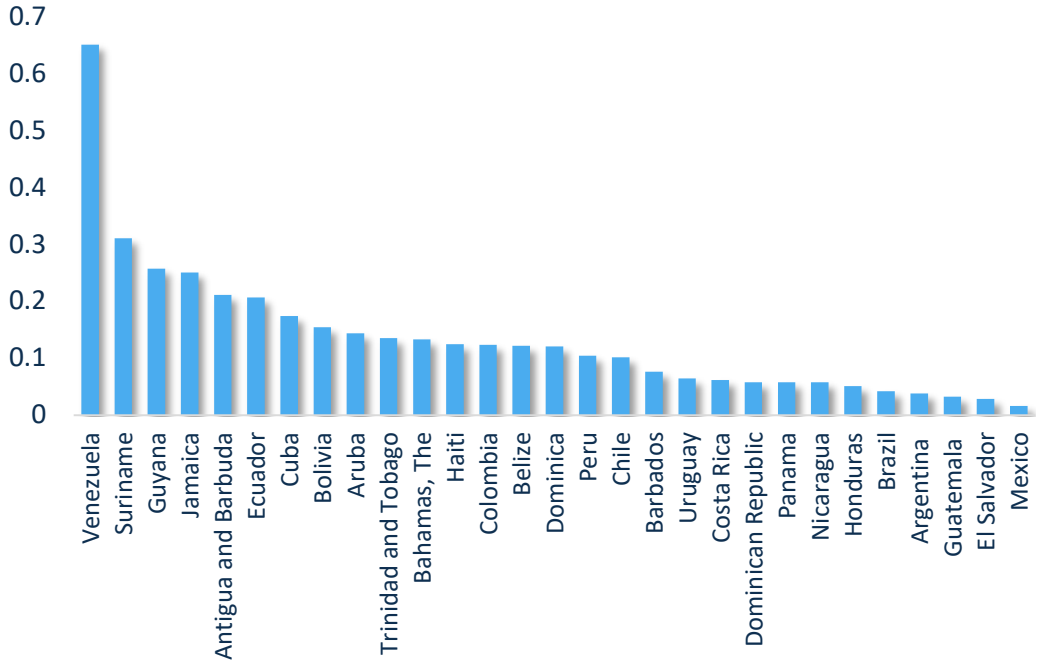
Despite the apparent benefits, few countries have been successful in overcoming a reliance on primary mineral or agricultural commodities

Policymakers often focus on short-term rents versus re-investment in critical investments in human capital, infrastructural and institutional assets (e.g. copper in Zambia versus Chile).

Export diversification (HHI) – Sub-Saharan Africa, 2017



Export diversification (HHI) - Latin America & Caribbean, 2017



Source: World Integrated Trade Solution

2 Routes towards economic diversification

Routes towards Economic Diversification

Trade is often a key success factor (e.g. East Asian manufacturing).

Diversification is no longer seen as simply requiring the emergence of new industries due to:

- Increased focus on firms—within sectors, exporters enjoy higher productivity and wages;
- Technological change and lower transport costs has split up production with GVCs and trade in tasks; and
- Pro-competitive regulatory reform and lower communications costs has facilitated trade in services.

Diversifying the range and quality of imported inputs can support upgrading and productivity growth in existing sectors, and allow new varieties of products to be developed.

Sustaining diversification requires a multi-pronged approach targeted at stimulating exports of agricultural and manufacturing products, and services.

- In most countries no single sector can provide the necessary export growth on its own.
- There are often interdependencies between sectors (e.g. services inputs into manufacturing).

3 Policies to support economic diversification

There is no magic recipe for diversification—there are multiple paths for success

Appropriate incentive frameworks

- Providing a clear and transparent business environment;
- Removing biases against exporting; and
- Ensuring effective competition in product, factor markets and backbone services.

Lowering trade costs

- Investments in transport infrastructure;
- Policy reforms to promote efficient logistics, reduce tariffs, and streamline NTMs;
- Services trade liberalization; and
- Regional integration.

Support to market, policy and institutional failures.

- Export promotion agencies to address information failures;
- Investment promotion;
- Growth poles;
- Special Economic Zones;
- Economic Corridors; and
- Clusters.

Facilitating adjustment

- Labor market reforms;
- Investments in education and skills;
- Addressing gender disparities in access to education, finance, and information;
- Policies to promote a well-functioning financial sector; and
- Support to innovation.

4 Drivers of successful diversification efforts

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Drivers of successful diversification efforts

- Policy and timing of investments must be specific to country circumstances and implementation capacity of governments.
- Political commitment is essential.
- The focus should be on export growth, FDI attraction, and increasing the range of goods and services exported.
- A strong, technically capable administration is important to manage the diversification process.
- Influential stakeholders with interests in non-mineral exportable sectors are desirable to offset the political influence of dominant sectors.
- Building human capital.

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