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Developing Productive Capacities in LLDCs: Policy Instruments and Lessons

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Outline of Presentation

- I. Background
- II. Why are Productive Capacities Important?
- III. Key Policy Areas for Developing Productive Capacities
- IV. Lessons for Landlocked Developing Countries

I. Background

- In 2017, Landlocked developing countries accounted for about 7 % of world population, 1.6% of global FDI inflows, AND less than 1 % of global exports and output.
- There are concerns that LLDCs are being marginalized in the global economy and that the international community should strengthen efforts to ensure that they derive a fair share of gains from the trading and investment system.
- One of the main reasons why LLDCs have not been able to effectively integrate into the global trading and investment system is the lack of productive capacities.

II. Why are productive capacities important?

- Economic development is the result of two interconnected processes: productive capacity building and structural change
 - Structural change involves reallocation of factors from low to high productivity activities
 - Productive capacities refer to the productive resources, entrepreneurial capabilities, and production linkages which together determine the capacity of a country to produce goods and services and enable it to grow and develop.
- The development of productive capacities is key to employment creation and poverty reduction in LLDCs

III. Key Policy Areas for Building Productive Capacities

5.1 Development Finance and Macroeconomics

5.2 Investment Promotion
and FDI

5.3 Industrial Parks and SEZs

5.4 Trade policy and strategic
market development

5.6 Technical and
Vocational Skills
Development

5.7 Agricultural and
Industrial Research

5.5 Local content policy

Development Finance and Macroeconomics

- Financial systems play a vital role in industrial transformation
 - SOUTH KOREA: is a good example of a country that has effectively used its financial system to foster transformation.
 - State ownership of commercial banks
 - Targeting development finance at sectoral and firm levels
 - Addressing financing needs of SMEs
- Macroeconomic policy can also play a crucial role in promoting productive investment and fostering transformation
 - Need appropriate real effective exchange rates
 - Interest rates should not be so high as to discourage productive investment

Investment Promotion and FDI

- Investment is a driver of productive capacity development
- But its contribution is not automatic. Governments have to have a strategic approach to FDI and a framework conducive to productive investment
- SOUTH AFRICA: uses a matching grant scheme to promote investment in manufacturing
- VIETNAM: in the 1980s used incentives to target FDI to priority sectors (labour intensive, electronics, automobile). Placed restrictions on FDI into services sector
 - Share of manufacturing in exports rose from 46 percent in 1997 to 70 percent in 2013

Industrial Parks and Special Economic Zones

- Industrial parks can lower transaction costs, reduce entry barriers, and facilitate skills, technology and knowledge transfer
- ETHIOPIA: has used this instrument to build productive capacities. Established the Hawassa Industrial Park in 2016
 - Power, water and one-stop services provided
 - Focus was on textiles
 - Attracted foreign firms including PVH (owner of Calvin Klein and Tommy)
 - Government invested \$250 million and created 60,000 jobs

Trade policy

- Trade policy is an important tool for industrial transformation
- Should be focused on increasing the technology content of production and exports to allow development of new sources of comparative advantage
- UGANDA: has used trade policy to diversify both export products and markets.
 - In 1995, Europe accounted for 80 percent of exports and in 2016 it accounted for 40 percent
 - Primary products accounted for 91 percent of exports in 1995 and in 2016 it accounted for 51 percent.
 - It expanded its trade policy space through integration into regional markets, macro stability etc

Local Content Policy (LCP)

- Can facilitate linkages between activities of lead firms and the domestic economy thereby creating employment, developing local capabilities, and distributing rents away from foreign firms.
 - Takes the form of quantitative requirements or incentive-based policies
- MOZAMBIQUE: Used LCP to link local businesses to the Aluminum Smelting supply chain and increase value addition. MOZAL was encouraged to act as a guarantor for SME loans, provide training and mentorship to local businesses
- BANGLADESH: used financial incentives and joint ventures to build local capacity in the garment industry.
 - DAEWOO was incentivized to use local fabrics and develop Bangladeshi managers skills

Technical and Vocational Skills

- Skills development is a driver of industrial transformation. They are needed to access and absorb technologies.
- Without the development of industrial skills, it is not possible to build long term capabilities necessary for productive transformation
 - Need both experience-based technical skills and formal education-based skills
 - Resolve skills-matching issues both from a current and future perspectives
- ETHIOPIA: introduced technical and vocational education and training (TVET) in 2008. It has been successful because
 - Involved partnership with the private sector
 - Curricula and activities are demand driven and capable of adjusting to ongoing changes in manufacturing sector
 - Quality standards were introduced and respected

IV. Lessons for Landlocked Developing Countries and LDCs

- Building productive capacities requires having macroeconomic policies consistent with the objective of production transformation
- Need a strategic approach to FDI and it should not be promoted at the expense of domestic investment.
- Pay attention to both the level, rate and quality of investment
- Align Technical, Vocational Education and Training programmes with private sector demand

- For local content policy to be effective, governments have to strike a good balance between compulsions and incentives
- LDCs should make strategic use of their existing trade policy space
- Linkages have to be effectively fostered for the domestic economy to really benefit from industrial parks.
- Genuine government commitment is also crucial in terms of sustainability and the attractiveness of the park to investors
- Regional cooperation can play a vital role in developing infrastructure needed for productive transformation in LLDCs.