LAKSHMAN KADIRGAMAR INSTITUTE
OF INTERNATIONAL RELATIONS AND STRATEGIC STUDIES

ECONOMIC TRANSFORMATION

Lessons From International Experience

Presented by Dr. Dirk Willem te Velde, Principal Research Fellow and Head,
International Economic Development Group, Overseas Development Institute (ODI)

Economic Transformation – lessons from international experience

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Presentation at LKI, 23th January 2020

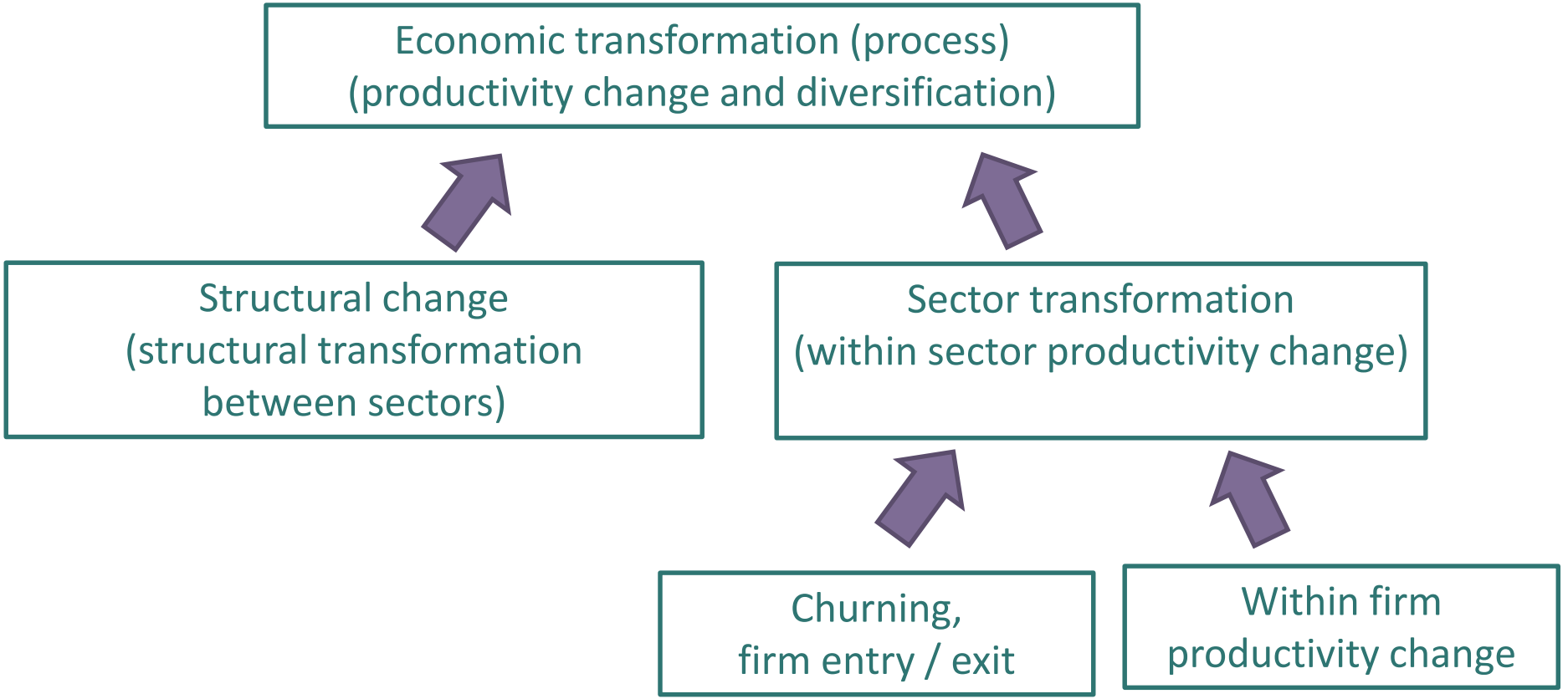
Overview / main issues

1. Why Economic Transformation (what is it, why, approach and measurement)

2. Country examples (Ethiopia, Kenya, Bangladesh, Cambodia)

→ Key message: Advances in economic transformation require **timely co-ordination** of appropriately **targeted** public policies; conducive rules of the game, economic fundamentals and institutions; and private entrepreneurship

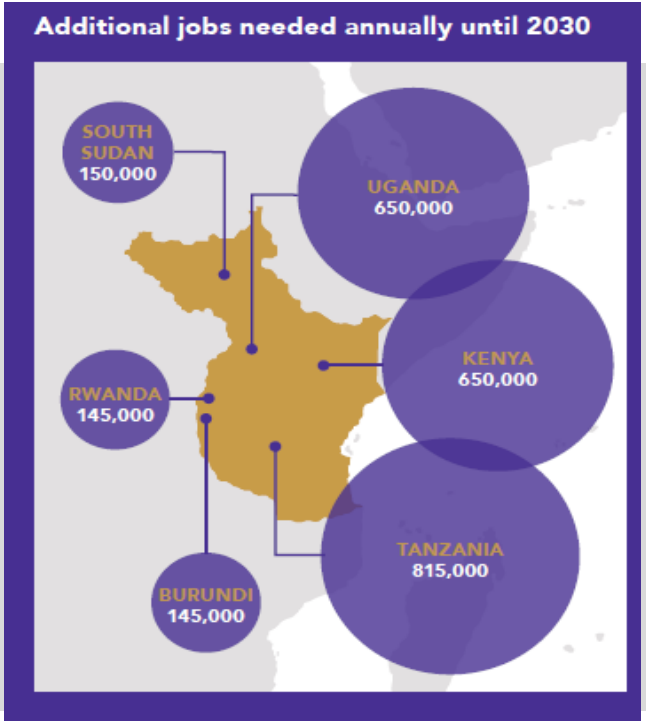
(informed by work on economic transformation: set.odi.org)



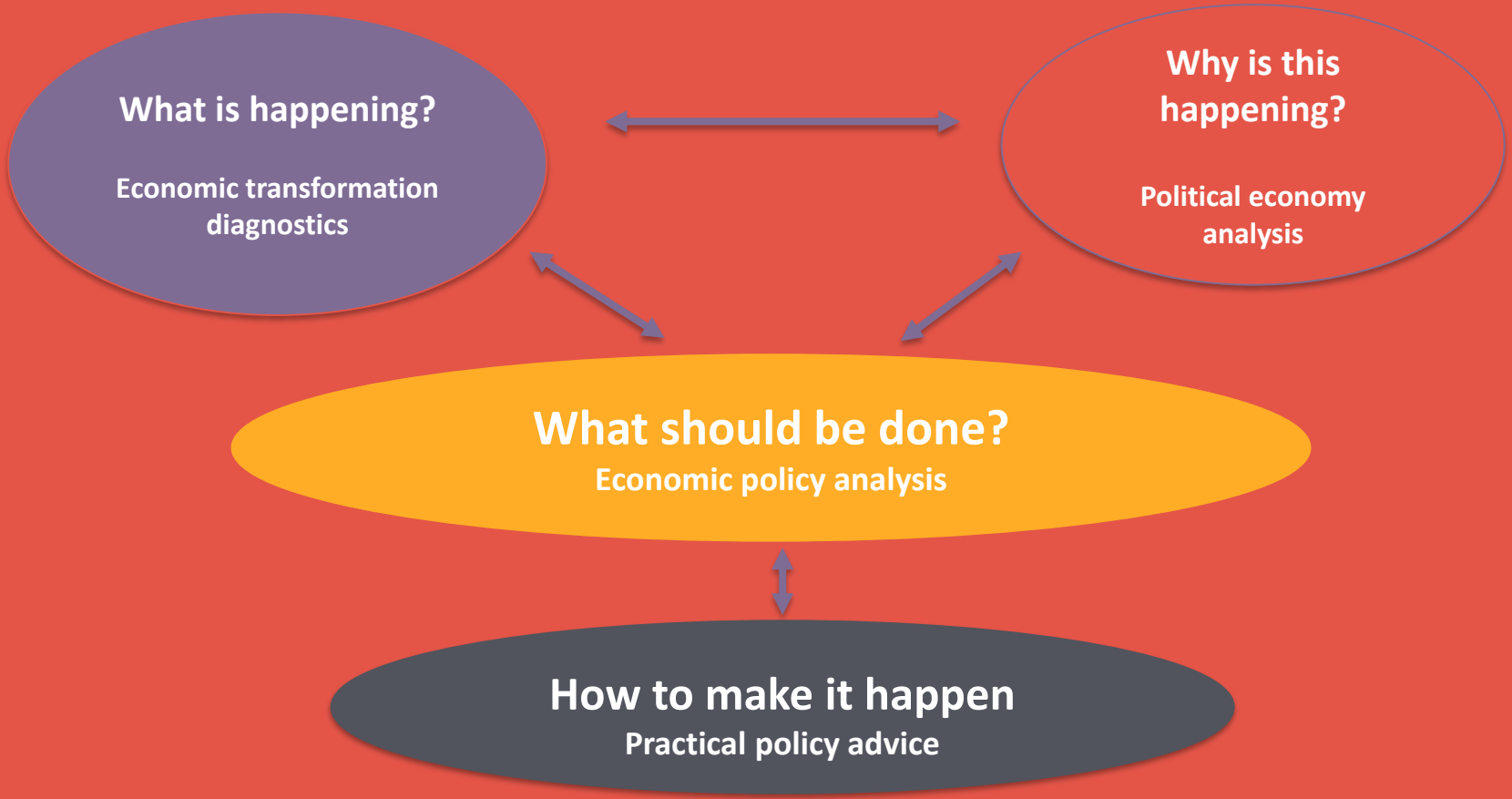
→ Productivity differentials at all levels, especially in low income settings, suggest large opps for ET

Why is economic transformation important for poverty reduction and inclusive growth?

- Qualitative: Ghana/Korea at some income level in 1960, Asian Tigers have transformed whilst most SSA have not (where GDP/cap remained lower, and poverty rates higher).
- Business as usual is not sufficient (low-quality growth based on high commodity prices & increased debt)
- ET associated on the supply side with
  - Productivity increases which determine living standards
  - Job creation and sharing of growth
  - Resilience to commodity price shocks
- ET associated on the demand side with lower unit cost of consumption goods and services including food, housing, and urban services – transport, energy, water
- ET usually involves new and greener technology (UNIDO, 2019)

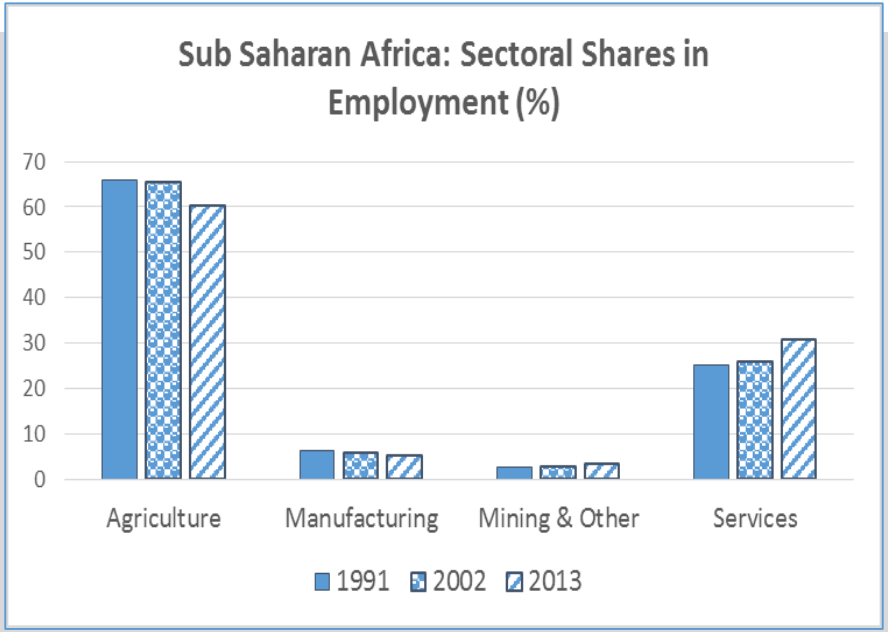


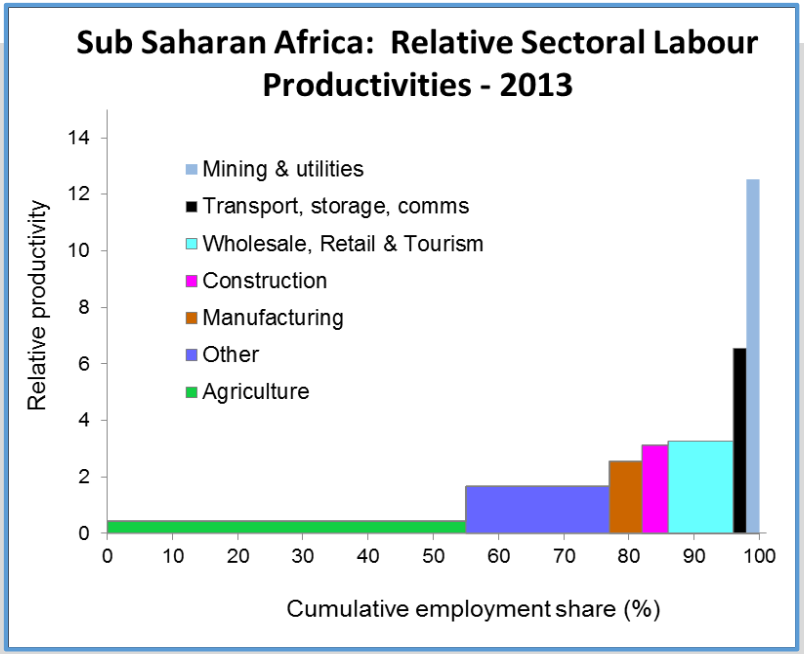
Source: SET/EABC (2018)


What is happening?
Economic transformation diagnostics
Why is this happening?
Political economy analysis
What should be done?
Economic policy analysis
How to make it happen
Practical policy advice

SOURCE:

1. **WHAT**: LACK OF STRUCTURAL CHANGE (ACROSS SECTORS) IN SSA, BUT HIGH POTENTIAL FOR PRODUCTIVITY CHANGE

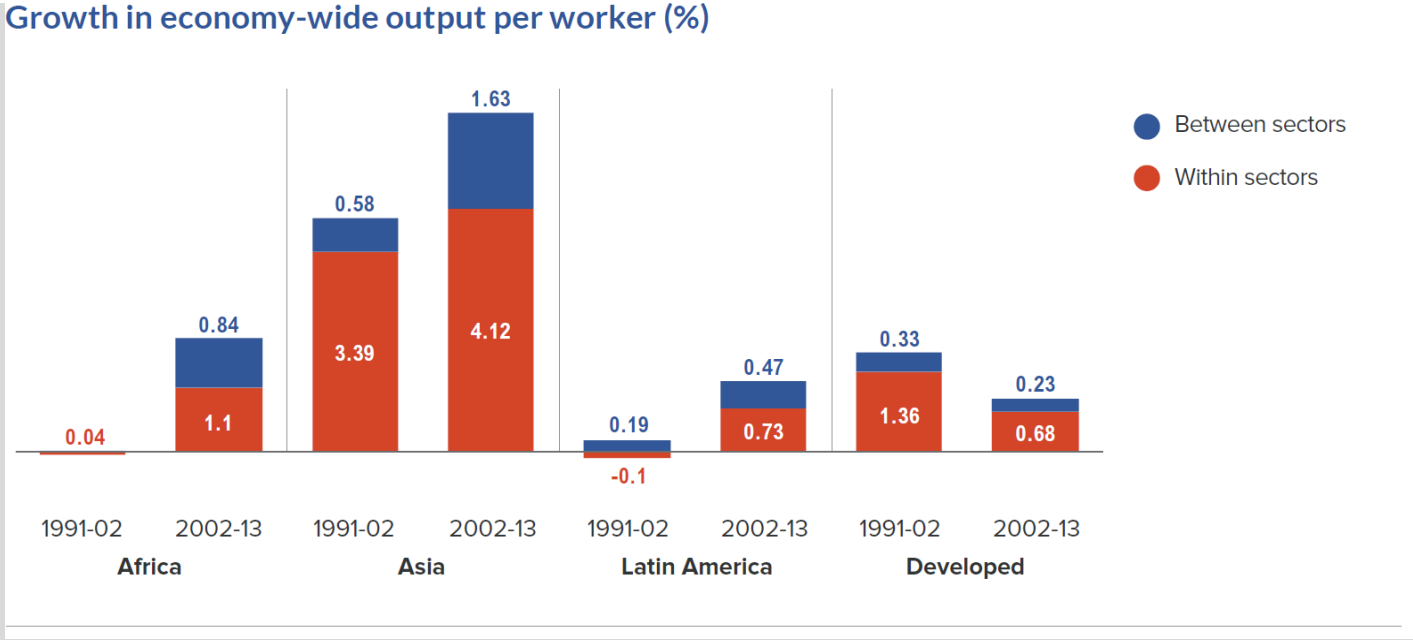




Source: NCE/SET (2016)

LACK OF AFRICAN LABOUR PRODUCTIVITY GROWTH

(IN AFRICA, STRUCTURAL CHANGE WAS LABOUR PRODUCTIVITY DECREASING 90S; RECENTLY SOME BETWEEN SECTOR MOVEMENT TO LOW GROWTH SERVICES SECTORS)



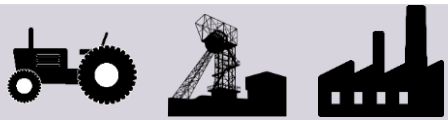
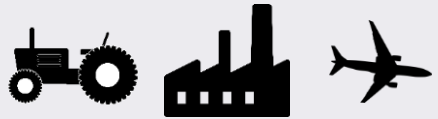
Source: NCE/SET (2016)

OFTEN NO LACK OF STUDIES AND METHODS TO DETERMINE PROMISING SECTORS (SEE E.G. ET DIAGNOSTICS ON PROMISING SECTORS **IN SET TANZANIA):**

- Resource endowments
- Sector labour productivity analysis
- Sectoral GDP and employment (I-O) multipliers
- Domestic value added (EORA) contribution to exports
- Revealed Comparative Advantage (RCA), past export specialisation
- Firm level productivity analysis (compared to other sectors, and other countries)
- Hausman product space
- Stakeholder views
- Gender analysis

2. **WHY** IS ET (NOT) HAPPENING?

EXAMPLE: **HORIZONTAL AND SECTOR-SPECIFIC CONSTRAINTS** AFFECT ECONOMIC TRANSFORMATION IN MOZAMBIQUE (REASONABLE CONSENSUS IN 30+ STUDIES)

Horizontal constraints	Sector-specific constraints	
• Capacity and skills shortages • Unreliable power supply • Restrictive labour regulations • Poor tax administration • Difficulty accessing finance • Corruption • Limited government and institutional capacity	• Poor transport infrastructure, including cabotage • Difficulty accessing land • Inefficient customs procedures	
	• Inefficient corporate income tax regulations • Failure to refund VAT credits, especially to exporters	
	• Lack of refrigeration facilities at ports • Lack of facilities to support processing activities • Poor supply of packaging • Limited testing, certification and traceability hampers access to export markets	
	• Large distances between forestry areas and processing mills • High tariffs on processed wood products in export destinations	
	• Weak use of modern technology	

WHY IS IT (NOT) HAPPENING (B): QUALITY OF POLICY PROCESS DIFFERS INDUSTRIAL POLICY QUALITY ACROSS AFRICA (AS OF 2016), ODI AND ACET (2018)

		Expert score of conduct and performance ①=weak, ⑤=strong				
Functional area	Performance expectations	Ethiopia	Kenya	Rwanda	Tanzania	Uganda
Quality industrial policy process	Effective lead agency Robust, inclusive process of formulating and implementing industrial strategies Monitoring of implementation	⑤	②	④	②	②
Conducive trade rules and trade facilitation	Sound tariff regime Active support for exporters Developing trade standards Efficient port procedures	②	③	③	②	③
Provision and regulation of Special Economic Zones, industrial or clusters.	Efficient legislation Coordinated and speedy action around zones	④	③	④	②	①
Effective investment facilitation, including aftercare	Clarity on roles, responsibilities and mandates of EPZAs, government ministries and IPAs Identification of suitable investors Active engagement with firms Supporting firms in-country	④	②	③	①	②
Local capability building (for local content or national capability acquisition)	Capacity building programmes (skills and technology development in tandem with private sector) Local content unit with clear negotiation strategies	②	③	②	③	②
Supportive infrastructure planning	Prioritisation of infrastructure needs of manufacturers Efficient port/airport handling	③	④	③	②	③
Learning with the private sector to address initial and emerging constraints	Trust-based relationships, feedback mechanisms Mechanisms that hold government to commitment	②	②	③	①	②
Selective, conditional support to building firm capabilities (including finance)	Banking system that supports industrial priorities	②	②	②	①	①

3. **WHAT** NEEDS TO BE DONE: POLICIES FOR ET

	General market enabling	Targeted interventions
Public actions to support structural change	Investment climate reforms Financial sector development Strengthening state-business Relations	Export push policies Exchange rate protection Selective industrial policies Spatial industrial policies National development banks
Public actions to support within-sector productivity growth	Building fundamentals Investments in basic production knowledge • Managerial good practices as public goods • Agricultural innovations Promoting competition	Management training Attracting foreign direct investment Export diversification Developing global value chains Increasing agricultural productivity

POLITICAL ECONOMY

PROBLEM DRIVEN

SECTOR FOCUSED

Source: McMillan, Page Booth and te Velde (2017)

4. **HOW TO DO IT**: LESSONS ON (FUNCTIONS OF) IMPLEMENTATION (BASED MAINLY ON ASIAN EXPERIENCES)

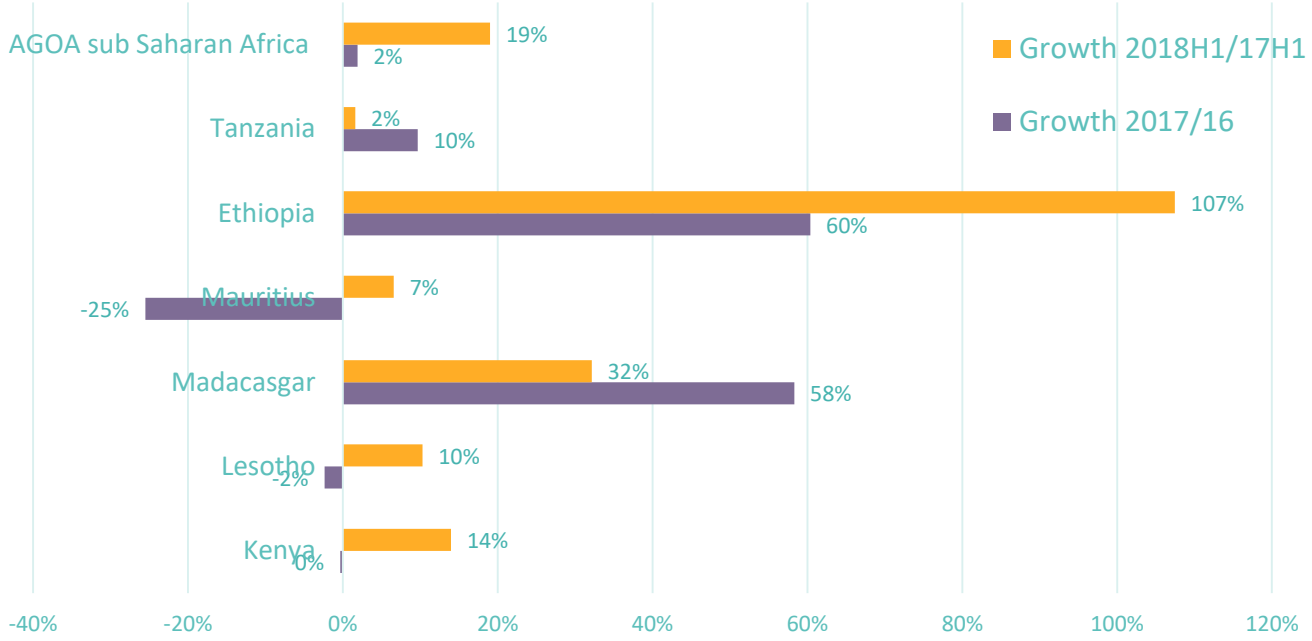
- Constructing a consensus among key actors that establishes *economic transformation as a* ***nation-building project***, with shared commitments beyond single electoral term;
- Giving at least *one* ***public agency sufficient autonomy****, budgetary control and political authorisation* to override interdepartmental coordination problems and engage in a practical way with *credible private sector organisations*;
- Creating institutional arrangements that can **coordinate a sufficient set of powerful public and private actors** so as to ensure (1) an appropriate level of technically justified public support to promising sectors or firms; and (2) conditioned on *mutually enforceable performance standards*; and
- Enabling discovery of approaches that work for transformation in the particular country context by means of ***explicit experimentation, good feedback and timely correction***.

Source: Ansu et al. (2016b)

Country examples (LICs, LMICs):

1. **Ethiopia**: industrial parks and AGOA exports of garments, low cost labour
2. **Kenya:** lack of attention to manufacturing, failure of co-ordination
3. **Bangladesh:** garments take-off, but failure to diversify, what now?
4. **Cambodia:** vulnerability of manufacturing sector (GVCs, digitalisation, preferences)

US imports of textiles and garments (AGOA – preferential trade access)
→ Ethiopia growing fast (from low base)



Evidence. Ideas. Change.

Source: US International Trade Committee

Ethiopia: ingredients of success in recent industrialisation (Arkebe)?

1. Create the necessary conditions for productive investment
Business climate alone not enough.

2. Avoid focussing solely on generic foreign investors. African governments should identify priority sectors and the most promising sources for better quality FDI, and should also target selected firms.

3. Build pockets of excellence and create an industrial ecosystem: Build and expand industrial parks. Ethiopia's approach to building an industrial ecosystem driven by learning from others but finding unique answers

Evidence. Ideas. Change.

https://www.odi.org/blogs/16535-will-2020-be-decade-Africa-economic-transformation

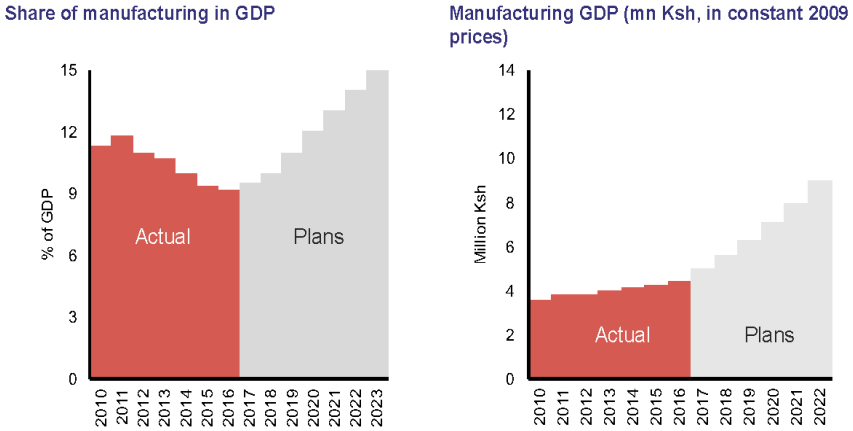
Hawassa Industrial Park (Ethiopia)

- Industrial Parks as tools to move to a more industrialised economy (from 2010)
- Ethiopia learned / adapted from other experiences
- Remarkable successes
  - Targeted / co-ordinated planning
  - Constructed in 9 months
  - 20-30,000 jobs, plans for 60,000
- But challenges remain
  - Retention / wages of workers
  - Housing
  - Transport

Evidence.
Ideas.
Change.

KENYA'S ACTUAL AND PLANNED LEVELS OF INDUSTRIALISATION

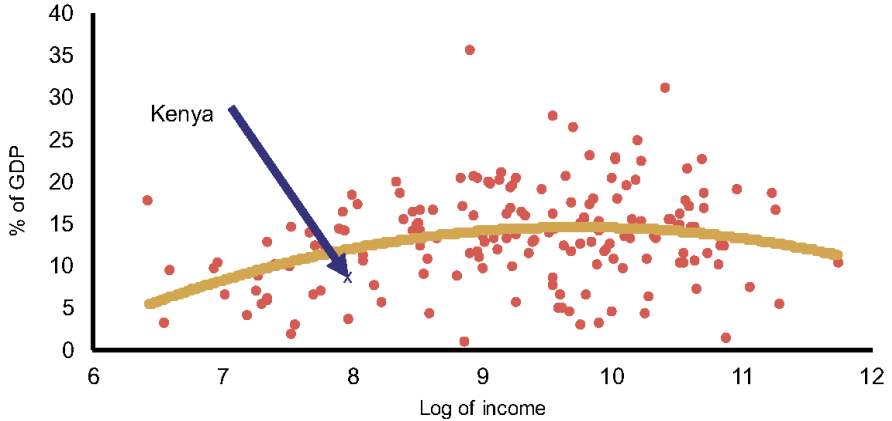
Figure 1: Setting ambitious plans to kick-start manufacturing production



Source: Kenya Economic Survey, Kenya National Bureau of Statistics: http://www.knbs.or.ke/index.php?option=com_phocadownload&view=category&id=107

Note: Planned increases from 2017 onwards.

Figure 2: Share of manufacturing in GDP vs income per capita



Source: World Development Indicators.

Note: Each dot represents a country (Kenya's arrow is based on Figure 1) (all reporting countries, 2013); the line is a fitted polynomial. Log of gross national income (GNI) per capita purchasing power parity (2011 prices) on horizontal axis.

Sources: KAM-ODI/SET (2017)

KENYA: WHAT NEEDS TO BE DONE? AND HOW?

Why a new industrialisation push can help create jobs

- Manufacturing creates jobs and a resilient economy and diffuses technology
- Its share in GDP has remained constant over four decades
- Kenya's strengths include garments, leather and agro-processing
- Its informal sector is underutilised
- It has strong policy frameworks (KITP and Vision 2030), but these urgently need focus and momentum

Effective public policies and regulation for manufacturing competitiveness

1. Create a business environment that is conducive to manufacturing investment
2. Enforce a fiscal regime that supports manufacturing
3. Make land ownership more affordable and accessible
4. Secure affordable, reliable and sustainable energy
5. Expand access to long-term finance for all manufacturing firms
6. Create an export push for manufactured products
7. Develop worker skills and support innovation for increased labour productivity

Efficient and effective implementation

1. Create a fit-for-purpose public service
2. Develop a coordinated value chain approach
3. Build trust and reciprocity for effective coordination and partnerships

Create 300,000 additional jobs and double manufacturing production in five years

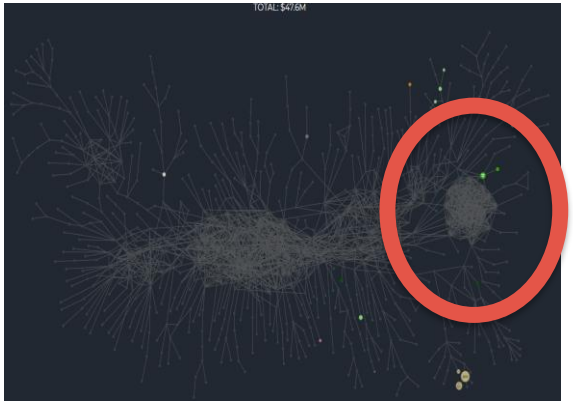
Ten policy priorities for transforming manufacturing and creating jobs in Kenya

Lack of co-ordination a problem(ODI,KAM: 2017)

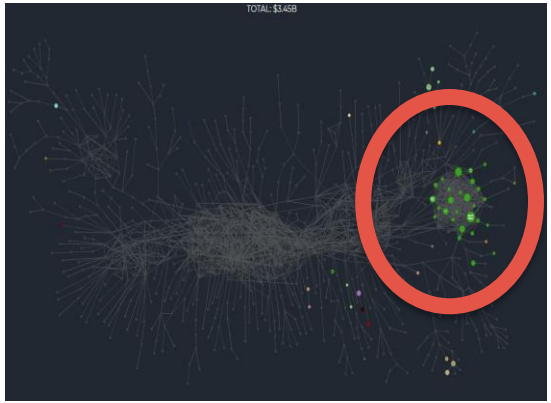
Bangladesh:

- Rapid growth based on RMG-led exports through preferential market access, letters of credit, and entrepreneurship (spillovers from Daewoo)
- Failure to diversify (in products & markets), facing preference erosion (LDC graduation) and other challenges

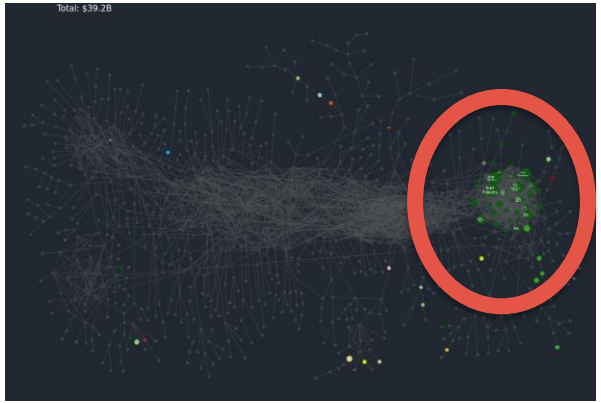
1972: $48mn



1995: $3.5bn



2017: $39.2bn



Hausmann product space based on exports data (1972-2017)

Evidence. Ideas. Change.

Bangladesh’s challenges in diversification: role of policy (protection, garment subsidies, political economy)

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Monday, November 25, 2019

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Commerce Minister Tipu Munshi speaking at the inaugural ceremony of the "Bangladesh Trade Policy and Negotia
Capacity Building Support Project" at a city hotel on Sunday. Policy Research Institute of Bangladesh (PRI) Chairma
Zaidi Sattar (2nd, left), its Director Dr. M. A. Razzaque (extreme left), Additional Secretary (Export) of the Ministr
Commerce Tapan Kanti Ghosh (3rd, left), Additional Secretary of the ministry Sharifa Khan (2nd, right) and Team Le
ODI-PRI Consortium Dr Dirk Willem te Velde (extreme right) are also seen — FE p

Policy blamed for single product reliano

FE REPORT

Commerce minister Tipu Munshi on Sunday said the country needs to be prepared for the post-2024 challenges following graduation from the least developed country, or LDC, status.

"We will graduate from the LDC status in 2024, there will be problems and challenges, we need to prepare our people for the challenges," he said.

He was speaking at the inaugural ceremony of the "Bangladesh Trade Policy and Negotiation Capacity Building Support Project" at a city hotel.

The ministry of commerce, in collaboration with the Overseas Development Institute (ODI) of the UK and the Policy Research Institute of Bangladesh (PRI)

Post-graduation challenges

'We have enough products to be competitive in global market'

the Trade and Advocacy Fund (TAF2+) of UKaid, initiated the capacity building project for the government officials of Bangladesh.

The project aims to provide training on trade policy and negotiation skills and conduct analytical studies on the upcoming challenges of trade.

Speaking at the programme, the commerce minister said Bangladesh has set its export target of $60 billion by 2021 and it is possible to attain through new products and value addition alongside the market diversification.

He said Bangladesh cannot ensure sustainable development without skilled manpower.

"We need to develop skill manpower in both the public and private sector to attain $60 billion export target," he said.

PRI chairman Dr Zaidi Sattar said trade is a complex issue and there are many complex aspects in trade negotiations.

"Bureaucrats should have basic idea about trade negotiations," he said.

He found policy problems to be the reason for the single product dependence on exports.

"It is not that our products

lack competitiveness-we
enough products to be co
tive in the global mark
problem lies with policy
lation," he said.

Additional secretary (
of the Ministry of Co
Tapan Kanti Ghosh s
country needs to secur
ential treatment they g
ferent markets.

He said the country
bureaucracies lack skill
negotiations.

He expressed the
junior officials in the bu
will be trained under th

Team Leader, OD
Consortium Dr Dirk
Velde presented a pap
project background, v
and way forward.

The project will

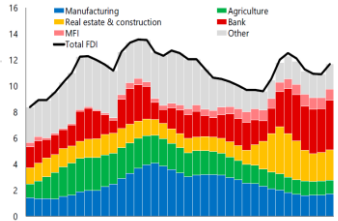
Continued to pag

Cambodia's achievements / challenges

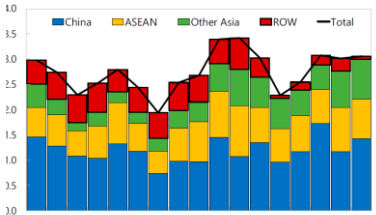
1. **Cambodia's hat-trick**: fast growth (7.6% for 2 decades), reduction in poverty (47.8% in 2007 to 13.5% in 2014) and inequality (Gini from 40 in 1997 to 28 in 2012).
2. **Concentration = vulnerability** (export products and destination, 75% of exports is garments, 50% from 5 countries –US/UK/JP/GE/FR ; 50% of FDI inflows from China (90% from Asia), much in construction recently.
3. **Little diversification,** hampering future growth (product space Cambodia/ Vietnam)
4. A few weak competitiveness indicators, unpredictable informal payments, lack of access/ high price of electricity, unfinished rural-urban transformation, high female labour participation rate, pros and cons of sector initiatives.

Evidence. Ideas. Change.

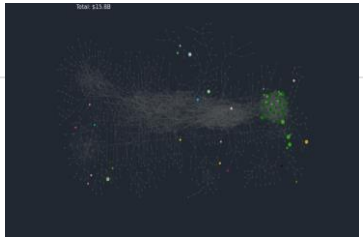
FDI by sector

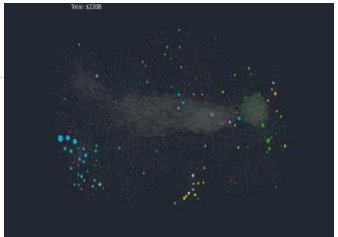


FDI by source



Product space 2017: Cambodia vs Vietnam





Differing speeds of digital transformation

AGRICULTURE: A GRADUAL START

MANUFACTURING: MISSED OPPORTUNITY?

SERVICES: SIGNIFICANT ADVANCES

E-GOVERNMENT: LAGGING BEHIND?

Five focal areas for an *inclusive* digital transformation

- Radically transforming innovation in the manufacturing sector
- Providing skills for the future
- Nurturing the digital start-up economy for an inclusive economy
- Protecting and enabling the most vulnerable groups to take part in the digital economy
- Promoting a public sector that leads by example.

Evidence.
Ideas.
Change.

Conclusions

- We know how to approach ET, in 4 steps, but often neglect the 4th step: how to. Targeted policies important, implementation key

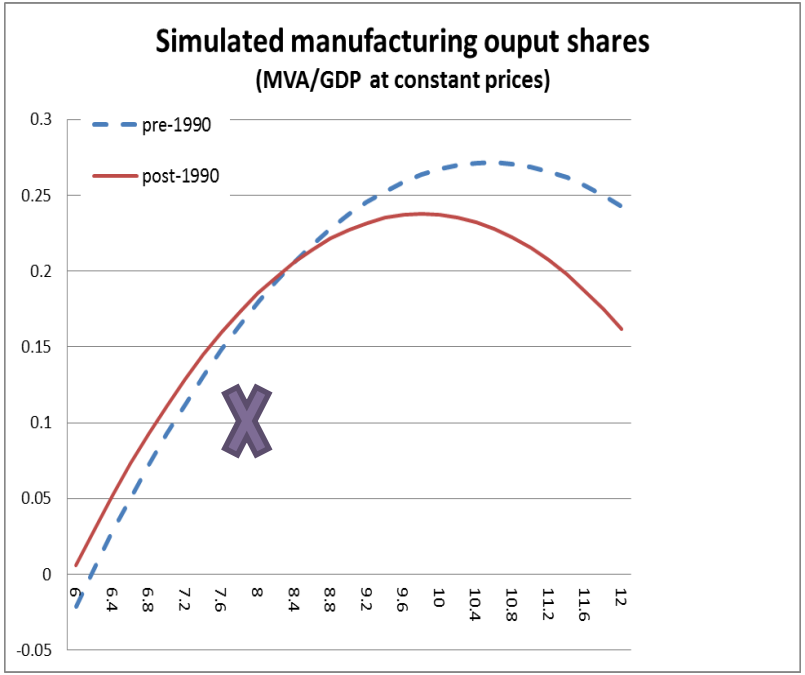
- Ethiopia shows how industrial parks can be done; contrasts with delays in Kenya. Leadership, targeting and co-ordinated implementation.

- Bangladesh (garments) and Cambodia (garments, tourism) developed well but now face challenges in diversification and responding to digitalisation without targeted action

Some reserve slides

Opportunities for African manufacturing

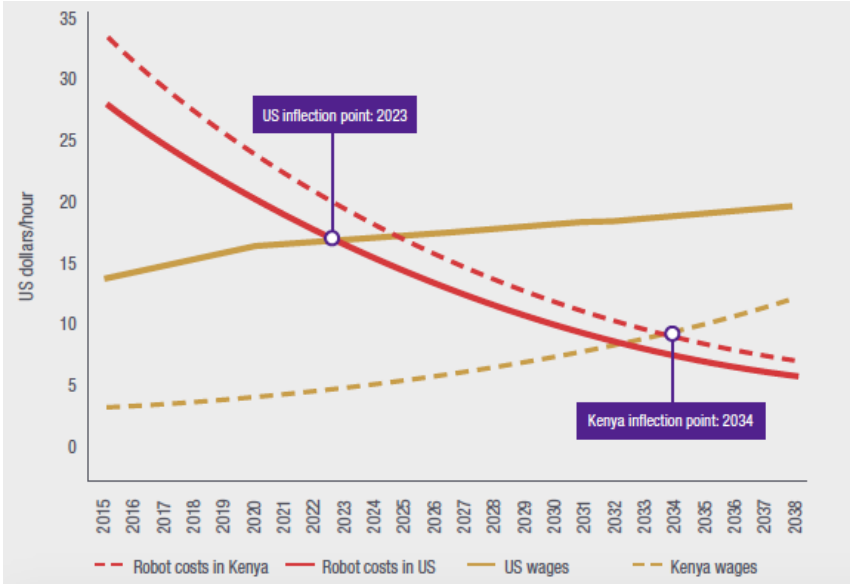
- **Rising wages in Asia, rebalancing in China, regional African markets, improving policies and institutions**
- Promising **sectors** for light manufacturing in Africa: **garments and textiles** (already strong growth in East African garment exports since 2009), **agro-processing**, **automobiles**, **consumer goods**
- SSA is far away from Rodrik's premature deindustrialisation manufacturing peak (see **X** in the figure)



Digitalisation and impact on African manufacturing

- Banga and te Velde (2018): digitalisation is opp and threat to manufacturing-led development
- Africa faces a digital divide (less internet penetration, less use, and fewer benefits)
- If Africa does not respond, it will lose manufacturing or never attract it
- Two solutions:
  - Build industrial capabilities
  - Prepare / target for a digital future

Cost robots to become cheaper than labour for some tasks but inflexion point later in Africa compared to US



Evidence.
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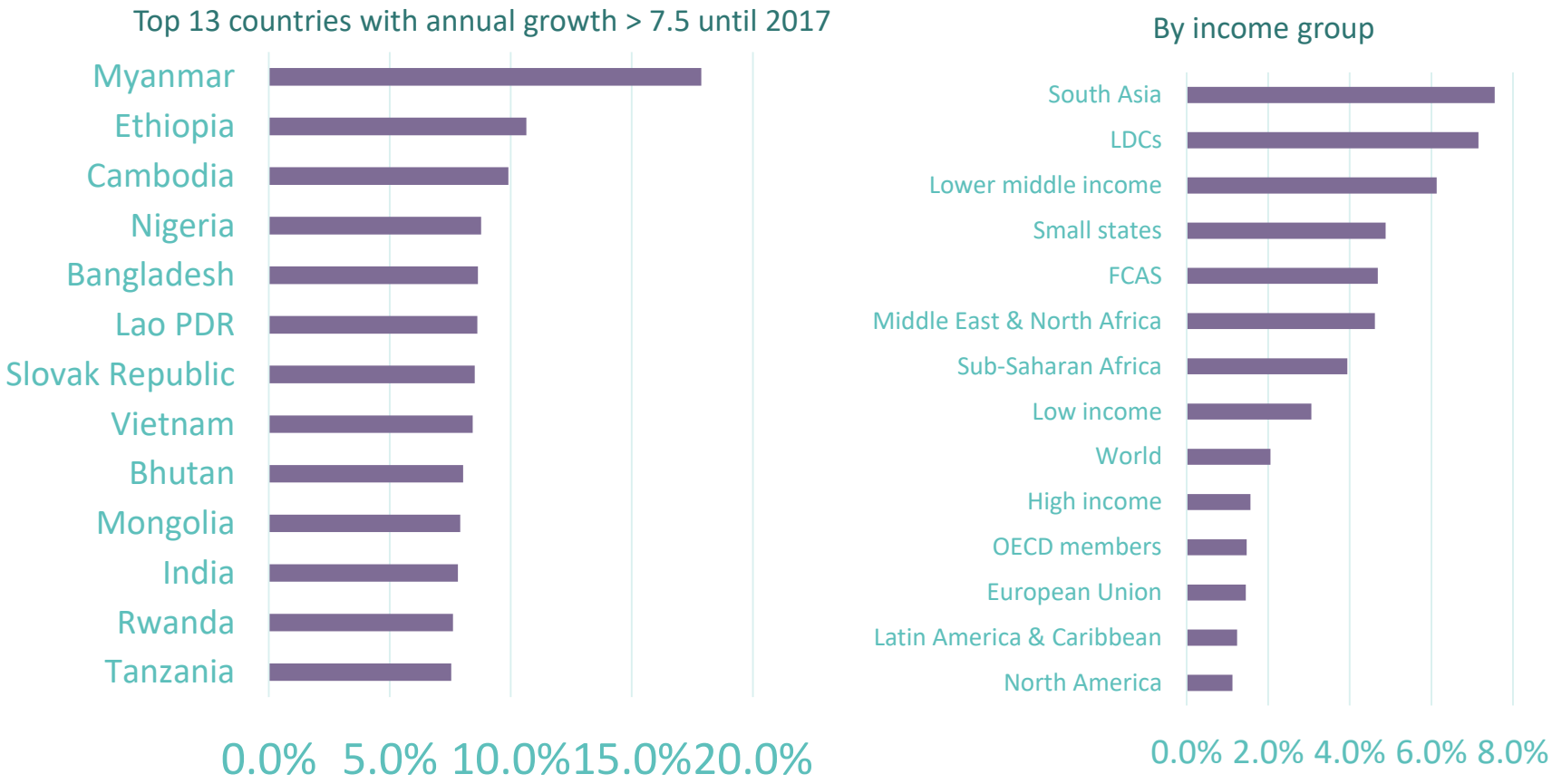
China, relocation and manufacturing jobs

- 103 million jobs in Chinese manufacturing in 2014, 25.4 million jobs in consumer electronics, household appliances, toys, clothing, footwear, hats, leather goods
- Survey (Stephen Gelb et al, 2018): 10% of light manufacturing firms consider relocating a first response to rising wages, or 2.5 – 10 million jobs. If ¼ end up in Africa this would be 2.5 million.
- Significant in relation to the 17.7 million formal and informal manufacturing jobs in sub Saharan Africa (2013), but small (1%) in comparison with the total number of *additional* 280 million jobs Africa needs to create simply to keep up with demographic challenges (until 2030)

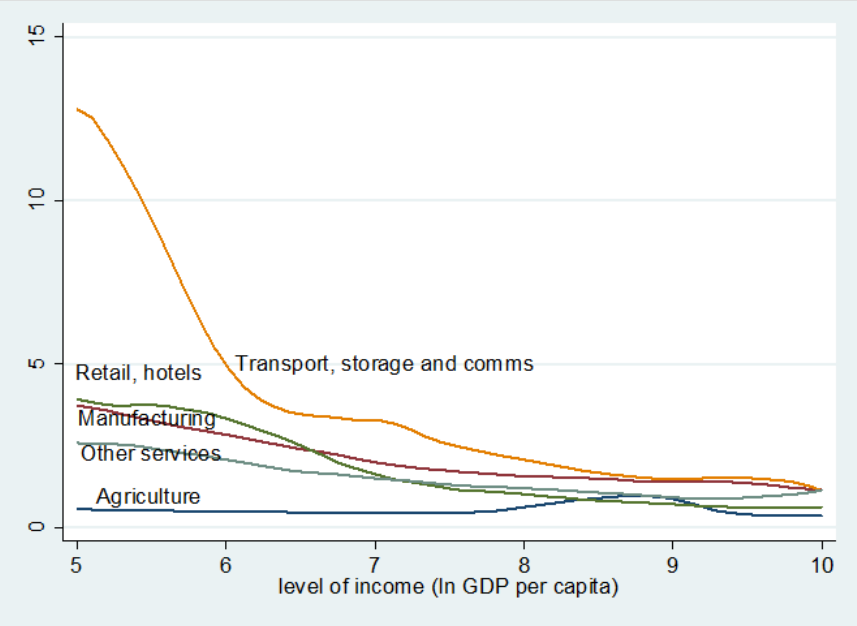
- → Target promotion efforts to those Chinese firms/clusters most likely to move

Annual manufacturing growth (% pa) since 2000



Source: WDI (2018), based on manufacturing in $2010, countries until 2017, groups until 2016 or 2017

LARGE RELATIVE LABOUR PRODUCTIVITY DIFFERENCES AT LOW INCOME LEVELS SUGGEST LARGE TRANSFORMATION OPPORTUNITIES FOR STRUCTURAL CHANGE



Source: Balchin et al. (2016) using UN and ILO data for 150+ countries 1991-2013

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