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POLICY BRIEF

BOOSTING INVESTMENT IN PRODUCTIVE CAPACITIES FOR TRADE: A CALL TO ACTION

The report of the Secretary-General to the fourteenth session of the United Nations Conference on Trade and Development (UNCTAD XIV) highlights the importance of building productive capacity and providing economic transformation (action line 1). It emphasizes the role of investment, trade, technology and entrepreneurship, and the nexus between them, as important means to achieve this. This policy brief focuses specifically on the need to boost investment in productive capacities for trade. It brings together some of the key messages and recommendations of the UNCTAD *World Investment Reports*, *Investment Policy Framework for Sustainable Development* and *Economic Development in Africa Report 2014: Catalysing Investment for Transformative Growth in Africa*.

Developing countries, including many of the least developed countries in Africa, have grown at almost twice the global average rate over the last decade. Nonetheless, structural transformation and the development of productive capacities for trade – necessary for low-income countries to benefit from greater integration into the global economy – have not yet taken root in many countries. Achieving this requires broadening the sources of growth. This implies, among other factors, boosting the level of investment, both domestic and foreign, and improving its contribution to productive capacities for trade. Investment promotion, investment facilitation and trade facilitation efforts need to be stepped up. Towards this end, the international community can complement the efforts of national Governments in developing countries.

Investment in productive capacities for trade: A virtuous circle

There is a virtuous circle between trade and investment policy; the complementarities between them and the interdependence of trade and investment require greater coordination at the national, regional and international levels. Trade facilitation measures will have positive effects on export-oriented investment as well as investment that benefits from facilitated (and cheaper) imports. Equally, investment facilitation measures, such as creating a conducive business environment through streamlined registration and licensing procedures, will have a positive effect on exports where they attract export-oriented investment and where they result in the build-up of critical productive assets, infrastructure and capabilities needed for exports. Figure 1 illustrates this circle and shows how targeted policy interventions on both the trade and investment sides could help to boost productive capacities, exports and the eventual structural transformation of the world's poorest economies.

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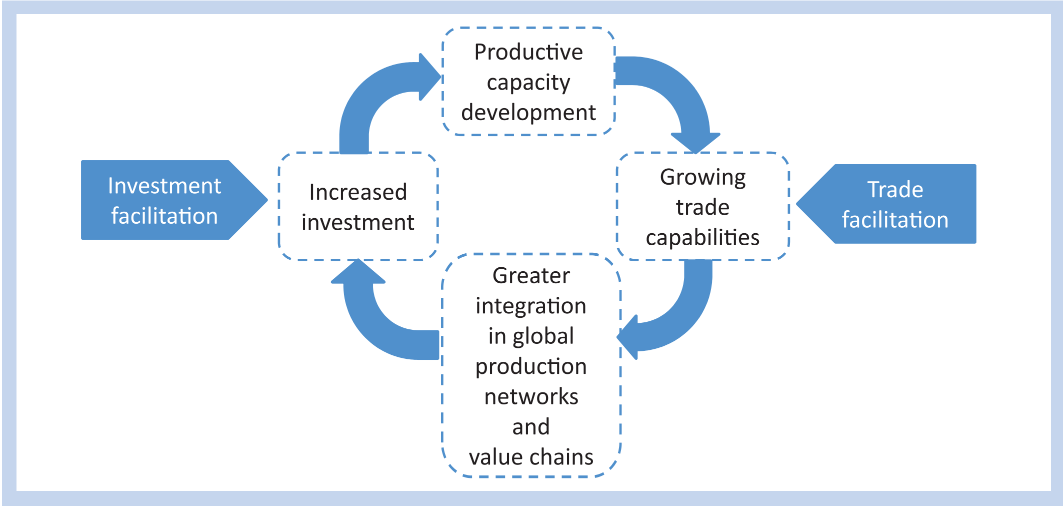
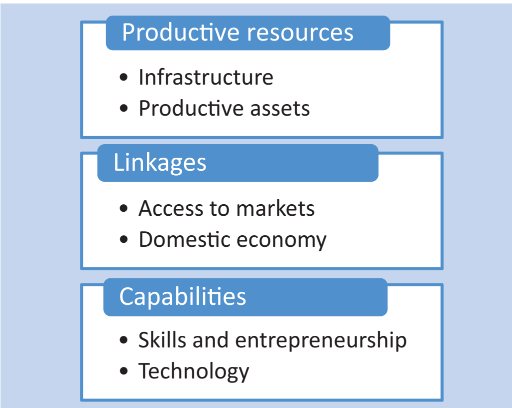
Figure 1
Trade and investment facilitation: Two sides of the same coin



Source: UNCTAD.

UNCTAD has always emphasized the importance of productive capacity development as a prerequisite to trade capabilities. Trade and investment policies working in a coordinated fashion can address the tripartite nature of productive capacities for trade, as defined by UNCTAD in terms of three pillars (see figure 2).

Figure 2
The three pillars of productive capacities for trade



Source: UNCTAD.

As illustrated in the *Economic Development in Africa Report 2014*, targeted investment policies in sectors of particular relevance can boost productive capacities across those three pillars. Such policies should boost the level and rate of both domestic and foreign investments. Foreign investment is particularly relevant where it enhances and complements domestic investment, and where international links enhance domestic capabilities and access to foreign know-how, technologies and markets. The following sections look at each of the three pillars.

The need to boost investment in infrastructure for trade

For productive resources and in particular critical infrastructure for trade and development, UNCTAD (as part of the action plan for investment in the Sustainable Development Goals) estimated the current investment in selected sectors in developing countries, their investment needs and the consequent annual investment gap between now and 2030, which stands at $1.2 trillion (table 1).

Table 1
Current investment, investment needs and gaps, and private sector participation in selected infrastructure sectors, in developing countries, 2015–2030

Sector	Estimated current investment[a]	Total investment required[b]	Investment gap[b]	Average private sector participation in current investment (percentage)
Power	260	790	530	40–50
Transport	300	560	260	30–40
Telecommunications	160	315	155	40–80
Water and sanitation	150	410	260	0–20
TOTAL	**870**	**2 075**	**1 205**	**25–50**

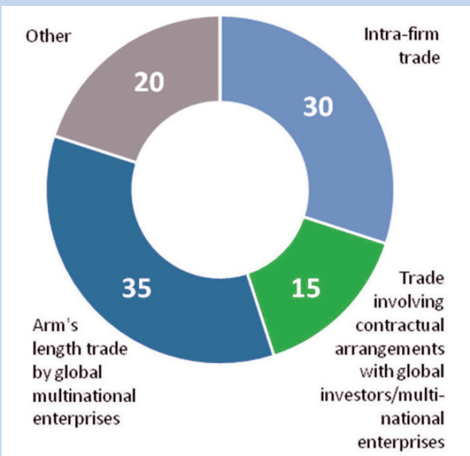
Source: Based on the *UNCTAD World Investment Report 2014: Investing in the SDGs – An Action Plan.*
Note: See the *World Investment Report 2014* for full table, notes and sources.
[a] In billions of dollars, latest available year.
[b] Annualized billions of dollars, constant price.

Bridging this gap in the selected infrastructure sectors will require increased public sources of finance such as aid (and aid for trade) and public investment by developing countries themselves. But private sources of finance, both domestic and foreign, will also need to play a role. UNCTAD has estimated that private sector participation in current investment for infrastructure, in developing countries, ranges from an average of 25 to 50 per cent. The adoption of specific investment policy measures, further discussed in the *World Investment Report 2014* could bring this rate closer to the developed country average of between 55 and 90 per cent. Such investment, and the policies required to promote and facilitate it (and to regulate it) at the national, regional and international levels, could make a huge difference to the trade capacities of the world's poorest countries.

Plugging into international production networks can increase exports and export capacities in developing countries

For the second pillar of productive capacities for trade, developing countries need to leverage their linkages between trade and the domestic economy (as well as bolster linkages within their own domestic economies) to build productive capacities. A crucial element of a coherent policy strategy to this end is trade policy that boosts international competitiveness and market access. The resulting opportunities may be further enhanced by integrating into the global production networks of multinational firms, which UNCTAD estimated account for as much as 80 per cent of global trade (figure 3).

Figure 3
Breakdown of global trade linked to the production networks of multinational enterprises (Percentage)



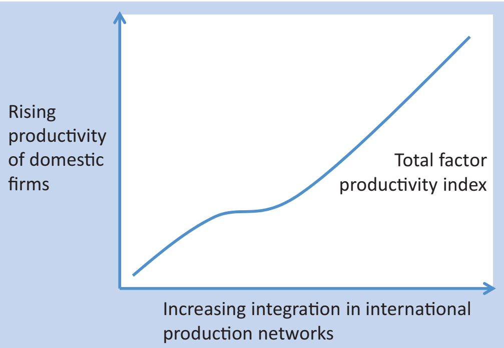
Source: Based on *World Investment Report 2013: Global Value Chains – Investment and Trade for Development*.
Note: Eighty per cent of global trade is linked to the production networks of multinational enterprises.

Many developing countries, including some of the poorest, are increasingly participating in multinational enterprise global production networks or global value chains. Global value chain links in developing countries can play an important role in economic growth. Domestic value added resulting from global value chain trade – that is, the contribution of such trade to gross domestic product (GDP) – can be significant relative to the size of local economies. In developing economies, value added trade contributes some 28 per cent to these countries' GDP on average, as compared to 18 per cent for developed economies (see *World Investment Report 2013*). However, many developing countries often find themselves producing and trading at the lower levels of global value chains, which provide lower gains in value added. An important challenge for these countries is to build the capacities required to move up the value chain and undertake the more sophisticated tasks that increase the benefits from participating in those global value chains. Here, investment policy plays a key role.

Greater integration in global production processes can help boost export capabilities

The third pillar of productive capacities for trade concerns the domestic capabilities of countries, such as local skills and technology. UNCTAD analysis found that there is a strong positive correlation between the integration of domestic firms in the international production networks of multinational enterprises and the higher productivity of those firms. Figure 4 tracks, from left to right, non-exporting firms, firms exporting at arm's length and firms importing and exporting as part of the networks of multinational enterprises. The positive correlation shown in the figure probably reflects a mutually reinforcing process where higher productivity of domestic firms is not only beneficial for growth but also connected to greater competitiveness in export markets.

Figure 4
Domestic productivity is closely correlated with integration in international production networks



Source: Based on World Investment Report 2013.

Global value chains can contribute to productive capacity development through several mechanisms, including technology dissemination and skills and knowledge development. They can also open up opportunities for longer-term industrial upgrading, especially in coordination with other policy areas such as science, technology and innovation policies that support technological learning and boost competitiveness. Trade and investment policy can target a number of global value chain development paths in developing countries in order to realize that potential. These paths include "engaging" in global value chains, for example by using measures such as local content requirements to increase linkages with local firms; "upgrading" along global value chains to try and capture relatively higher value parts of the value chain, and "leapfrogging" and "competing" via global value chains. More policy detail on these development paths is available in the *World Investment Report 2013* and in the report of the Secretary-General to UNCTAD XIV (exploiting the trade-investment nexus for diversification).

Coordinated policies require a multilateral response

Policy measures can target both sides of the trade and investment circle, as illustrated in figure 1, but it is important to recognize that policies on one side can have impacts on the other side – both positive and negative (see table 2). It is therefore important to ensure that policymaking is coordinated at all levels and on both sides: trade and investment. UNCTAD has argued that a piecemeal and fragmented approach will fail to bring about the kind of structural transformation and growth that is, for example, envisaged by the 2030 Agenda for Sustainable Development. Greater efforts are also needed at the international level to boost investment for trade and ensure that it contributes to productive capacity development, and ultimately to the beneficial integration of developing countries in the global economy. Towards these ends, UNCTAD has been working on two tracks: first, it has produced the UNCTAD *Investment Policy Framework for Sustainable Development* that serves as a reference guide for policymakers in formulating national investment policies and in negotiating investment agreements. Secondly, it has suggested that, in the absence of a multilateral system approach, the best way to make the international investment agreement regime work for sustainable development is to collectively reform the regime with a global support structure. The World Investment Forum has provided a platform for discussion on investment policy for development. This could provide a basis for further efforts by the international community to address the trade and investment challenges faced by the world's poorest economies, especially the least developed countries.

Table 2
Selected trade and investment promotion measures and their potential impacts

Effects of trade policy measures on investment	
• Trade facilitation (applying to imports and exports) • Export promotion (e.g. export finance, credit guarantees, trade fairs)	⇒ Positive effect on export-oriented investment by reducing the cost of multiple border crossings on the import and export sides and through expedited exports; of particular relevance in time-sensitive global value chains ⇒ Positive effect on market-seeking investment that benefits from facilitated and cheaper imports
• Preferential or free trade agreements, including rules of origin and sector-specific agreements	⇒ Positive effect on investment that benefits from easier and cheaper trade between member countries, strengthening regional value chains ⇒ Positive effect on market-seeking investment through economies of scale from serving a larger market ⇒ Consolidation effect on investment, primarily through mergers and acquisitions, as a result of reconfiguration of global value chains in member countries
• Market access preferences (e.g. Generalized System of Preferences, Everything but Arms initiative, African Growth and Opportunity Act)	⇒ Positive effect on foreign investment in preference-recipient countries targeting exports to preference-giving countries
Effects of investment policy measures on trade	
• Inward investment promotion (in particular for export-oriented foreign direct investment, including financial, fiscal, and other incentives, e.g. subsidized infrastructure, market access preferences and regulatory concessions in special economic zones)	⇒ Positive effect on exports, possibly with higher imported content, and at risk of distortive effects ⇒ Negative effect on export competitiveness if incentives result in increased costs of production once phased out
• Investment facilitation (e.g. reduced registration and licensing procedures, access to land).	⇒ Positive effect on exports, possibly with higher imported content, where facilitation helps attract export-oriented, or efficiency-seeking investment

Source: UNCTAD.

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