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Promoting value addition and the enhancement of domestic productive capacity through local economic empowerment

Note by the UNCTAD secretariat

Executive summary

A key challenge in the integration of developing countries into the global trading system is the range and technological content of the goods and services they produce for export. Promoting value addition and enhancing domestic productive capacity is therefore of continuing importance in developing countries as they seek to participate beneficially in global trade. In addition to domestic productive capacity, the market access conditions under which goods and services are traded present formidable challenges. This note discusses trade policy issues relevant to addressing such challenges, with a view to contributing to increasing developing country participation in international markets.

A carefully planned strategy may use a combination of horizontal, vertical and qualitative diversification. Market entry costs, as well as quality upgrading, pose greater difficulties for smaller companies and in low-income countries. Regional cooperation in conformity assessment systems and regulatory frameworks can pave the way for new, non-traditional exports that can develop within regional production networks. Governments and relevant stakeholders will need to partner in such endeavours.

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Introduction

1. Empirical evidence shows that increased participation in international trade can catalyse economic growth and foster sustainable development. The 2030 Agenda for Sustainable Development and the Sustainable Development Goals, in particular Goal 17, identify several actions whereby international trade and trade policy can contribute to the more complete and beneficial integration of developing countries into global merchandise trade. In 1995, the share of developing countries in global merchandise trade was 27.7 per cent; by 2018, it had risen to 44.6 per cent. Yet many developing countries, such as the least developed countries, small island developing States and commodity-dependent developing countries, are marginal actors in global merchandise trade or participate in a way that does not achieve expected results. In 1995, the share of the least developed countries in global merchandise trade was 0.5 per cent; in 2018, 1 per cent. Enhancing the integration of developing countries into the international trading system hinges on many factors; among the most important are productive capacity for export and market access conditions affecting imports and exports. This note addresses the challenges faced by developing countries in these areas.

I. Challenges in adding value and boosting productive capacity

2. A typical challenge in adding value and boosting domestic productive capacity in developing countries is exemplified by experiences in commodity-dependent developing countries. Some developed countries and countries with economies in transition are also commodity producers. For example, Australia is a major producer of minerals, oil and food; Canada is an important producer of oil, food and timber; the Russian Federation is one of the world's largest producers of oil and gas; and the United States of America is a leading producer of oil and food. However, commodity sectors in developing countries play a more central role in the integration of these countries into global trade than do such sectors in developed economies. About 65 per cent of developing countries are commodity dependent. In these countries, export earnings from commodities represent at least 60 per cent of total merchandise export earnings. Such dependency makes commodity-dependent developing countries vulnerable to commodity price fluctuations and to the stimulus provided by commodity trade to economic growth and development. Data on developing countries covering the 1960s to the mid-2010s show that the coefficient of correlation between changes in commodity prices and changes in income per capita is 0.79, and Africa and South America are the regions with the highest incidence of commodity dependence.[1] In these regions, economic growth is strong in periods of high commodity prices and weak when the price cycle trends downward. Given that commodity prices follow cycles characterized by long episodes of low prices and relatively short episodes of high prices, economic growth in such countries follows a similar cycle.

3. Commodity price cycles impact economic growth through several channels, including price volatility and declining terms of trade; the effects of commodity prices on fiscal and monetary policies; and the direct and indirect effects of commodity prices on firms and households. With regard to price volatility, the terms-of-trade argument posits that in the long term, commodity prices display declining terms of trade, resulting in revenue erosion for commodity-dependent developing countries. Such a reduction in resources limits capacity to fund development projects, thereby affecting capacity to grow and advance human development. Moreover, highly volatile prices heighten uncertainty in these countries, discouraging investment and blurring development planning, thereby threatening the sustainability of development projects. The effects of commodity prices on macroeconomic variables may be experienced through the phenomenon of Dutch disease. Many developing countries experience de-industrialization in the period following the discovery of a major natural resource. The hollowing out of the economies of commodity-dependent developing countries increases vulnerability to the vagaries of international commodity markets. Commodity dependence is also associated with high budget deficits when export revenues decline; exchange rate fluctuations due to movements of capital; and, in periods of price downturns, unsustainable debt. High macroeconomic volatility leads to economic slowdown in these countries. With regard to the effects of commodity prices on microeconomic variables, firms and households in these countries are exposed to the abovementioned negative macroeconomic effects, which harm firm profitability and erode real household income. More directly, although net food-buying households may benefit when food prices decline, exporters of food and beverages such as coffee and cocoa see revenues drop. This may have a

[1] UNCTAD, 2016, *[Group of] 20 Policies and Export Performance of Least Developed Countries* (United Nations publication, New York and Geneva).

direct effect on food security and spending on health and education and other areas of welfare. Other economic agents in commodity sectors, such as collectors, traders and exporters, may also be affected by falls in income.

4. The relationship between commodity dependence and economic growth underlines that commodity dependence is a development challenge. The most effective way to shield economies from the deleterious effect of commodity dependence is product diversification. There are two forms of such diversification: vertical diversification, by adding value to primary commodities; and horizontal diversification, by producing and exporting more products. A third, non-exclusive alternative, called qualitative horizontal diversification, is to add value to a product by improving quality, broadly understood, including by acknowledging environmental value or conformity with higher sanitary or technical standards.

5. Vertical diversification implies that producing countries add value to raw primary commodities, in order to successfully extract their economies from the entry level of the commodity value chain to higher segments of the chain. If the process of transformation of a commodity is deep enough, it results in the creation of a new product that is less exposed to the problems faced by the commodity sector, for example, the potential of diversifying from cotton to cotton by-products (box 1). Another benefit of deep value addition is that a new product can command a higher price, which increases the share of value captured by the producing country. This is important, given the unequal distribution of value, whereby downstream actors in a value chain (retail, packaging and branding) capture a disproportionate amount. If the transformation of a primary commodity is not deep enough, a new product may appear to have been created, yet it may be affected by the same problems affecting primary commodities. Therefore, to qualify as a viable diversification strategy, value addition must lead to a product that is substantially different from the underlying primary commodity. In other words, value addition must be deep enough.

Box 1
Developing cotton by-products

Commercial or subsistence uses of agricultural crops typically target only one part of a plant, such as the seeds, fibre or fruit, which may represent only a small proportion of the total plant mass. Absent commercial applications for the remaining stalks, stems, leaves or husks, these crop residues are often wasted, as they are underutilized, as unprocessed fodder or household fuel, or destroyed. Similarly, at each node of an agroprocessing value chain, residues without profitable applications are often disposed of as waste. This represents a considerable volume of wasted biomass energy, organic material and nutrients. In cotton-growing countries in Eastern and Southern Africa, the main cotton crop residues are stalks and leaves, representing around 70 per cent of the total mass of the plant. In these countries, pest management regulations require farmers to destroy stalks. In other cotton-producing countries, innovative technologies have been developed to process such residues into commercially viable products. In India, for example, the Central Institute for Research on Cotton Technology has developed processes to use the high cellulose content in cotton linters in currency paper and nanocellulose applications; businesses have begun to use ginning and spinning residues to produce absorbent cotton wool, including for medical dressings; and a thriving industry has grown in the last decade in processing cotton stalks into compressed biomass briquettes and pellets, which are in high demand as substitutes for dirty fuels such as charcoal and coal and non-renewable fuels such as fuel oil and liquified petroleum gas.

Based on this example, cotton-producing countries in Africa could consider diversifying and adding value to cotton by processing stalks into biomass briquettes and pellets. The simple, small-scale technologies and business models in this regard that have succeeded in India are feasible for implementation in Africa. Such transformation of production would represent a significant achievement in adding value to cotton and other crops and expanding access to cleaner, modern energy sources, while reducing deforestation and greenhouse gas emissions, thereby contributing to the achievement of the Sustainable Development Goals and the targets of the Paris Agreement under the United Nations Framework Convention on Climate Change. There are some challenges. Establishing a cost-effective supply of raw material – cotton stalks and other agroresidues – is the primary business-related challenge. Secondary challenges include raising awareness among farmers and entrepreneurs of the potential applications for cotton stalks and creating incentives for end users to obtain pellet stoves or convert boilers.

Source: UNCTAD, based on United Nations Development Account project 1617K on promoting cotton by-products in Eastern and Southern Africa, implemented in Uganda, the United Republic of Tanzania, Zambia and Zimbabwe in 2016–2019.

6. Horizontal diversification means that countries diversify the number of goods they produce and export. This could be through value addition, as discussed, or through the production of other products not directly related to the main commodity on which the economy depends, or both. For example, an economy dependent on cocoa can diversify not only by producing and exporting cocoa powder but also by growing other agricultural commodities such as bananas, coffee and palms, as well as by producing non-agricultural products such as manufactured goods. This is illustrated in the example of Costa Rica in box 2.

Box 2
Costa Rica: An example of diversification

In 1965, coffee represented 42 per cent of total merchandise exports from Costa Rica and bananas, 26 per cent. In 2016, coffee represented less than 3 per cent of total merchandise export revenue and bananas, about 12 per cent. The most important export sector was medical instruments and appliances, accounting for 18 per cent of total merchandise export revenue. Other important sectors were fruit, fresh or dried (11 per cent); orthopaedic appliances (5 per cent); and electronic circuits (3 per cent). Costa Rica has diversified production into products that do not face the same risks and vulnerabilities as do traditional export products. As Costa Rica has moved into high-value manufactured export products, including fruits such as cut pineapples, the economy has improved its terms of trade and reduced exposure to price shocks that affect commodities more than they do manufacturing products.

Source: UNCTAD and Food and Agriculture Organization of the United Nations, 2017, *Commodities and Development Report 2017: Commodity Markets, Economic Growth and Development* (United Nations and Food and Agriculture Organization of the United Nations, Sales No. E.17.II.D.1, New York and Geneva).

7. Several policy lessons can be learned from the diversification experience and industrial policy in Costa Rica. First, a clear and realistic diversification strategy is required, with dedicated institutions for implementation. In Costa Rica, a ministry of exports, along with export and investment promotion centres, was created to foster diversification. Second, the type of diversification to be pursued must be carefully thought through. Costa Rica fostered the production of non-traditional exports in both the agricultural and non-agricultural sectors, including shrimp, cut flowers, pineapples, palm hearts, textiles and manufactures. The establishment of export promotion zones provided incentives to potential investors, who were required to export at least 75 per cent of production. High-technology manufacturing took place in the zones, including of electronic circuits, which was a first step into electronics manufacturing and digital industry in the country that further developed into research and innovation and other related services. It also sent a strong signal globally, attracting subsequent foreign direct investment. Third, human capital is key to any successful diversification strategy. The high literacy rate in Costa Rica resulting from a universal education policy has enabled the workforce to benefit from the opportunities created by the diversification strategy. Fourth, decades of sustained effort and adjustments in reforms and policies are required for success. An initial import substitution industrialization strategy did not succeed in Costa Rica, mainly due to the small size of the domestic economy. Export growth was then adopted as a long-term growth strategy. Fiscal reforms were carried out, such as the provision of financial incentives to attract non-traditional export industries, through subsidies and other tax-related incentives. The agricultural sector was among the first sectors to benefit. This illustrates that diversification must be considered a long-term strategy that requires adjustments along the way. Fifth, a combination of vertical and horizontal diversification may be used. In Costa Rica, agriculture was used as the driver of diversification through the expansion of a number of crops produced for export and, where relevant, value addition. Costa Rica began to export pineapples in the 1980s and built a manufacturing industry around this commodity, investing in cutting, packaging and canning operations, to export consumption-ready cut pineapples. By 2012, Costa Rica had become the world's largest exporter of pineapples. Other similar value-added exports include orange juice, cassava and many processed fruits. Sixth, macroeconomic stability contributes to success. Exchange rate stability, in particular following structural adjustment in the 1980s, helped Costa Rica expand its exports over time and stabilize its terms of trade.

8. The example of Costa Rica illustrates a more general empirical finding that inputs that exhibit low productivity and are not easily substitutable have negative impacts across an entire value chain. These are weak links in an economy and their presence reduces the impact of diversification efforts unless they are addressed in a coherent and comprehensive way.[2] The structure of sectors in an economy and their interactions affect performances at the national level.

II. Challenges in accessing markets

9. Adding value requires knowledge, access to technology, infrastructure and other inputs. Participating in a production chain is one way to add value. Production networks capitalize on the comparative advantage of the different tasks and available capabilities in a country. Developing countries may share one stage in a chain and join a global production network without needing to participate in and be competitive at all stages of production and marketing. Most current trade takes place in regional or global value chains. This possibility offers opportunities, yet also poses some challenges.

10. Countries diversifying production and exports need to compete in international markets with their new products, final or intermediate, and ensure access to these markets. Beyond tariffs, regulatory trade control measures de facto affect market access and add costs. Fragmentation through production chains exposes producers to increased trade costs, as intermediate goods cross borders multiple times before reaching a final market destination. To participate effectively in regional or global value chains, countries need to consider import and export costs; effective market access, determined not only by tariffs but also and more importantly by non-tariff measures; and private trade and sustainability-related product standards.

1. Trade costs

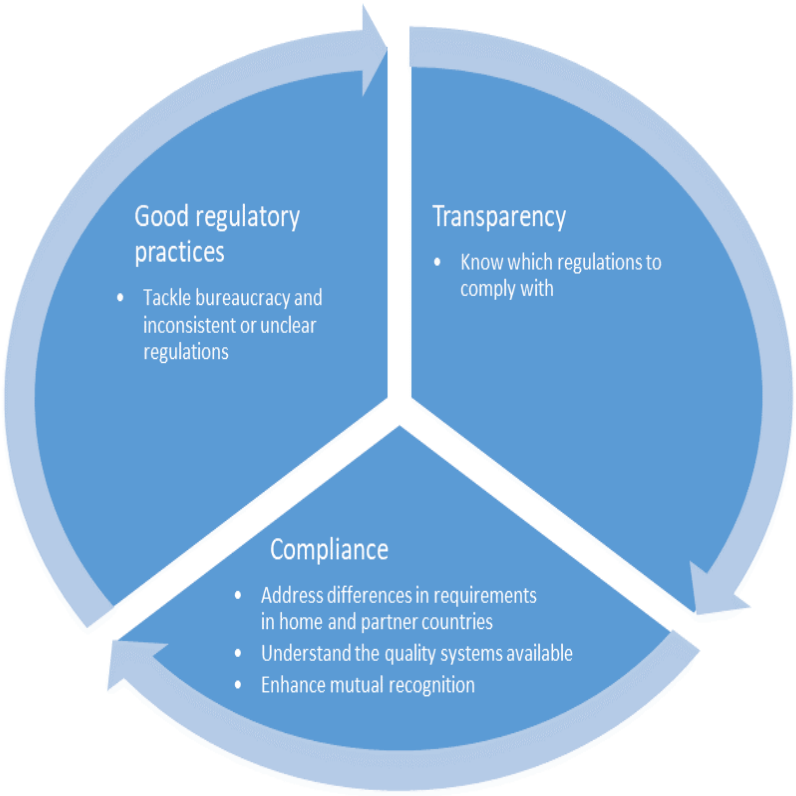
11. With regard to trade costs, import and export processes need to be efficient, bearing in mind that some imports are needed to develop exports. Regulations and processes for imports and exports affect the productivity and viability of a product for trade. Bureaucracy, inconsistent or complex regulations and variability or a lack of transparency add to the final transaction costs, making it difficult for developing countries to diversify exports. This is a policy area that is usually neglected. Goods cross borders multiple times before reaching a final export market. Consequently, trade costs accumulate along a value chain. There are low-level development traps associated with non-tariff measures, and participation in the production chains of countries with higher costs becomes infeasible. Trade networks through value chains require close coordination and timely delivery, and develop when costs, in particular government-induced costs, are low.[3]

12. Policies for reducing trade costs are not directly oriented to a diversification strategy but are a steppingstone on such a path. High trade costs may prevent diversification strategy policies from achieving and delivering effective results. Trade costs related to non-tariff measures include costs related to information on how to export to a certain market (the value of transparency); costs related to compliance with requirements, once information is available; and costs related to bureaucracy in home and partner countries incurred when good regulatory practices are not implemented (figure 1). There is also a close connection with the cost of customs processing or trade facilitation, usually measured in days of delay, discussion of which is beyond the scope of this note.

[2] UNCTAD, 2014, *Weak Links and Diversification* (United Nations publication, New York and Geneva).

[3] MJ Ferrantino, 2012, Using supply chain analysis to examine the costs of non-tariff measures and the benefits of trade facilitation, available at https://www.wto.org/english/res_e/publications_e/wtr12_forum_e.htm.

Figure 1
Policy areas to be addressed to reduce trade costs related to non-tariff measures



Source: UNCTAD.

13. With regard to transparency, there are various tools are available on the import requirements of major markets. In recent years, UNCTAD has led an effort to collect and systematize information on non-tariff measures in a way that is comparable across countries and reliable for comprehensiveness within each country. This information, at the six-digit level of the Harmonized Commodity Description and Coding System, is available for more than 100 countries.

14. The quality system available in a country, namely laboratories and accreditation facilities, impacts capacity to comply with regulations for many products in export markets. Almost three out of every four dollars of global exports are affected by at least one non-tariff measure; the most common types are technical barriers to trade, in particular for non-food products. Moreover, not only are almost all agrifood products regulated, but the average number of measures, usually sanitary and phytosanitary measures, for each such product is the highest. Products must comply with such regulations by undergoing a conformity assessment process showing that they meet the requirements of relevant standards. Such assessments are inherent to exporting, and the capacity for verifying conformity required in developing countries is significant. Independent conformity assessment becomes more important when inputs or final products come from a country that may have different production standards. The simplest way for a country to ensure conformity with its requirements is through independent certification and testing by internationally accredited laboratories and certifying institutions; "standards are needed to protect consumers and concerns about information and traceability are even more acute in a global value chain world".[4] The quality system available determines compliance capacity with regulations and suitability for importation.

15. At the national level, it is important to implement good regulatory practices, to avoid unnecessary bureaucracy and incoherent regulations stemming from different government departments. Statistics show that export-related non-tariff measures are common.[5] Exporters often experience difficulties at home even

[4] Organization for Economic Cooperation and Development, 2018, Trade policy implications of global value chains, Policy brief, available at https://www.oecd.org/trade/topics/global-value-chains-and-trade/.

[5] UNCTAD and the World Bank, 2018, *The Unseen Impact of Non-Tariff Measures: Insights from a New Database* (United Nations and the World Bank, Geneva).

before reaching an export market. Customs and administrative procedures, or procedural obstacles, is an area in which costs can be significantly reduced. Implementation of the Agreement on Trade Facilitation of the World Trade Organization, leading to the installation of trade facilitation infrastructure, can reduce trade costs significantly, enabling developing countries to participate more effectively in global trade.

16. Countries may address trade costs through regional cooperation. In general, cooperation in dealing with trade barriers between trading partners, in particular under regional integration, reduces the obstacles encountered by traders and allows for the consolidation of export diversification in new or emerging non-traditional exports. For example, an initiative under the Continental Free Trade Area in Africa aims to resolve non-tariff barriers reported by the private sector as unduly increasing trade costs. In addition, "the simultaneous reduction of trade costs in several neighbouring countries is likely to have benefits over and above the benefits to each individual country".[6] Regulatory cooperation can encourage diversification by reducing trade costs. One direct way of achieving this is through the mutual recognition of conformity assessments in sectors of interest and further harmonization in some instances for key products.

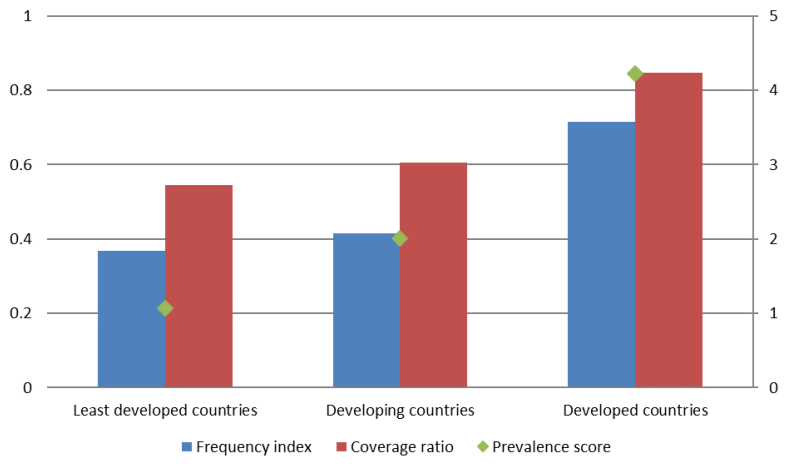
2. Non-tariff measures

17. With regard to costs arising from non-tariff measures, it is significant that almost three quarters of global exports are affected by at least one such measure. Regulations affecting trade include technical barriers to trade and sanitary and phytosanitary measures, as well as licences and quotas, price-affecting measures and financial or exchange rate regulations. Often, the lack of publicly available information on the import requirements in partner countries poses an obstacle and cost in itself.

18. The UNCTAD Trade Analysis and Information System database provides detailed and comprehensive publicly available information on import and export requirements stemming from official regulations for more than 100 countries. The database computes descriptive statistics in an aggregated manner on the pervasiveness of non-tariff measures. The data indicate that developed countries regulate a larger share of their trade than do other countries, as measured by an indicator called the coverage ratio, and the average number of non-tariff measures for each product is higher in developed countries, as measured by an indicator called the prevalence score (figure 2 (a)). Agrifood products are more intensively regulated than manufactures or natural resources in all country groupings (figure 2 (b) and (c)).

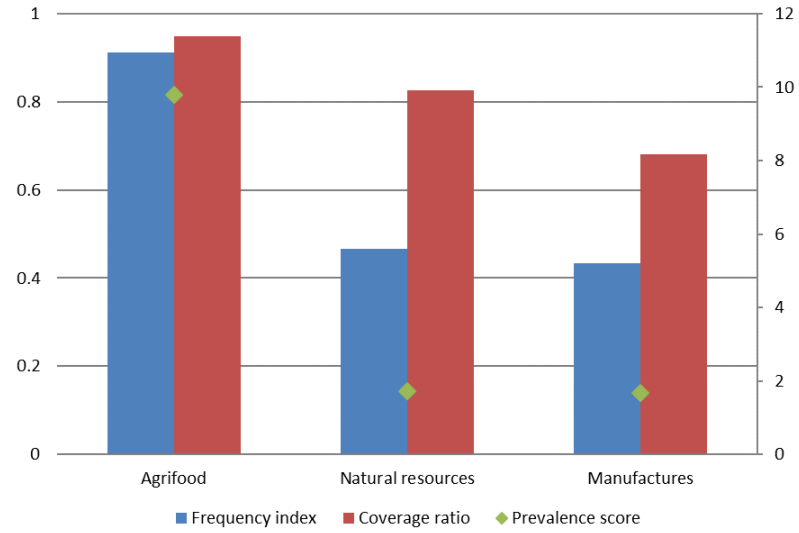
Figure 2
The pervasiveness of non-tariff measures, by country and main product groups

(a)

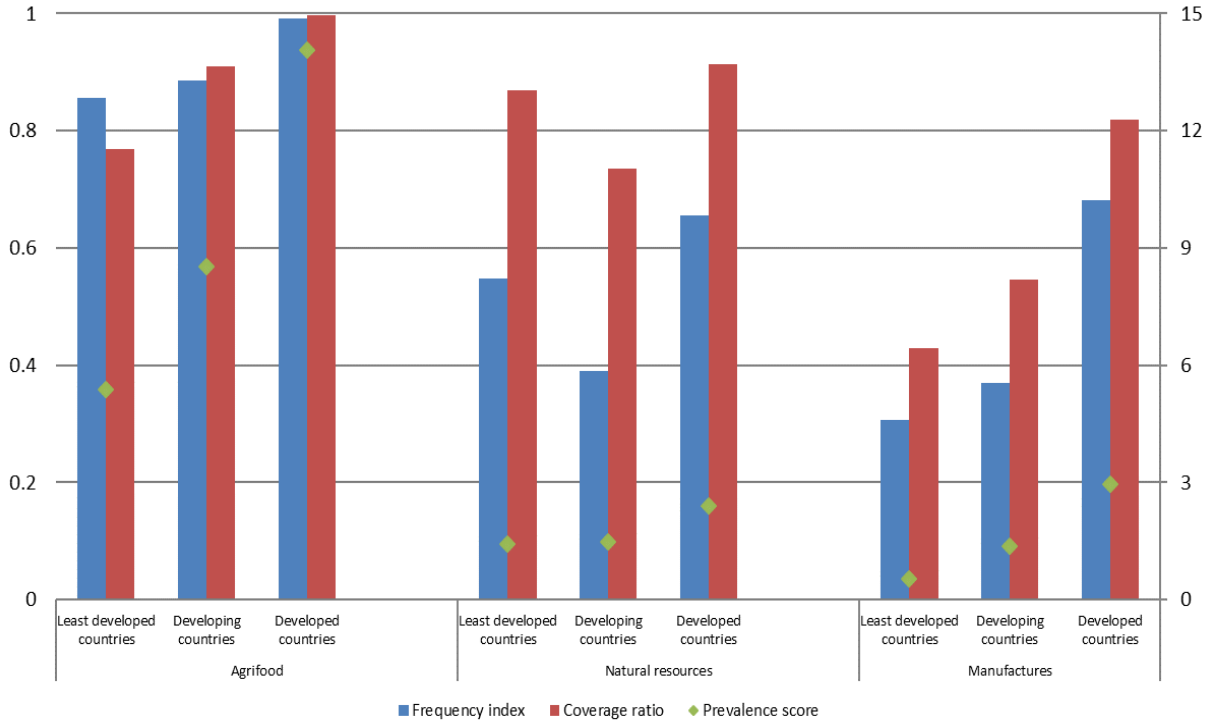


[6] Ferrantino, 2012.

(b)



(c)

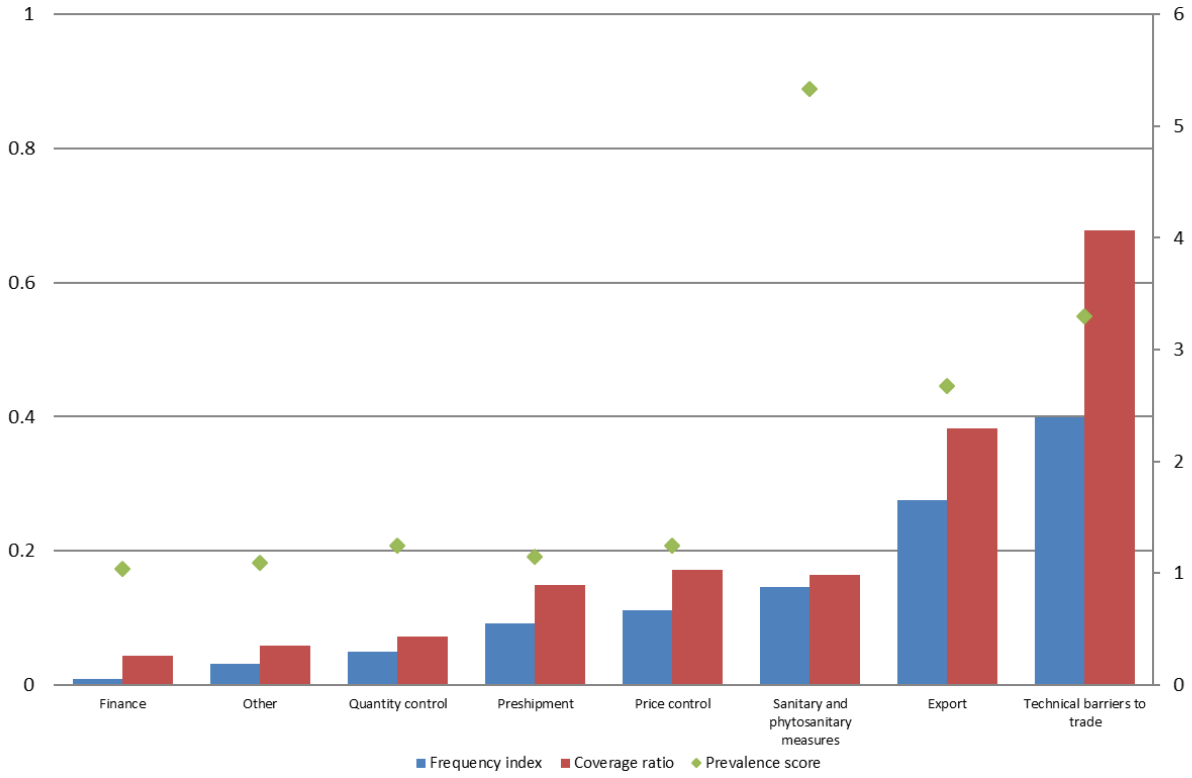


Source: UNCTAD calculations, based on the UNCTAD Trade Analysis and Information System database.

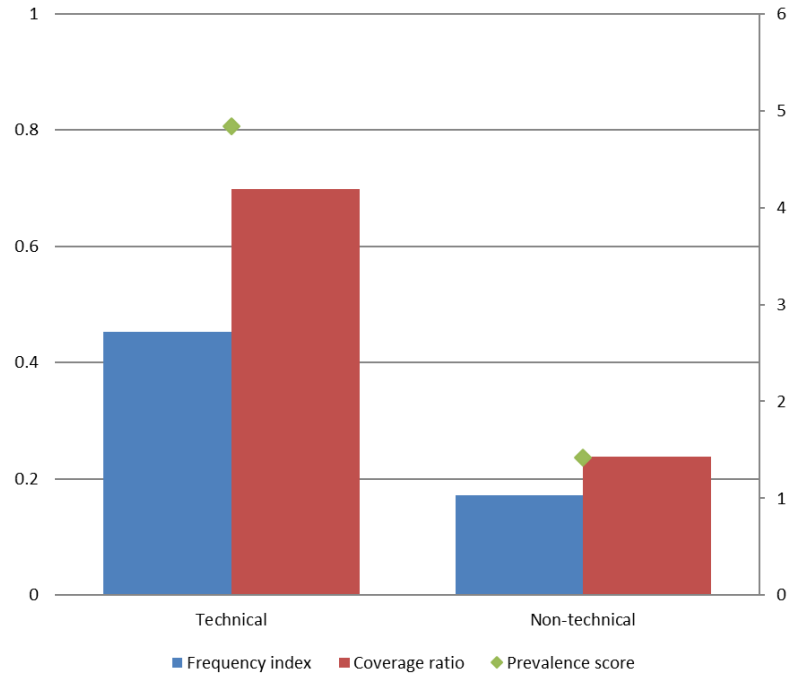
19. With regard to non-tariff measures by type, technical barriers to trade are the most common in international trade, followed by export measures, that is, the requirements that an exporting country imposes on its exports before they leave the country. Sanitary and phytosanitary measures are less pervasive, as they largely apply only to agrifood products. However, the average number of such measures is the highest of all types of measures (figure 3 (a)). Technical measures – sanitary and phytosanitary measures and technical barriers to trade – are more frequently and more intensively used than others, by broad economic sector and by region (figure 3 (b) and (c)).

Figure 3
The most common non-tariff measures

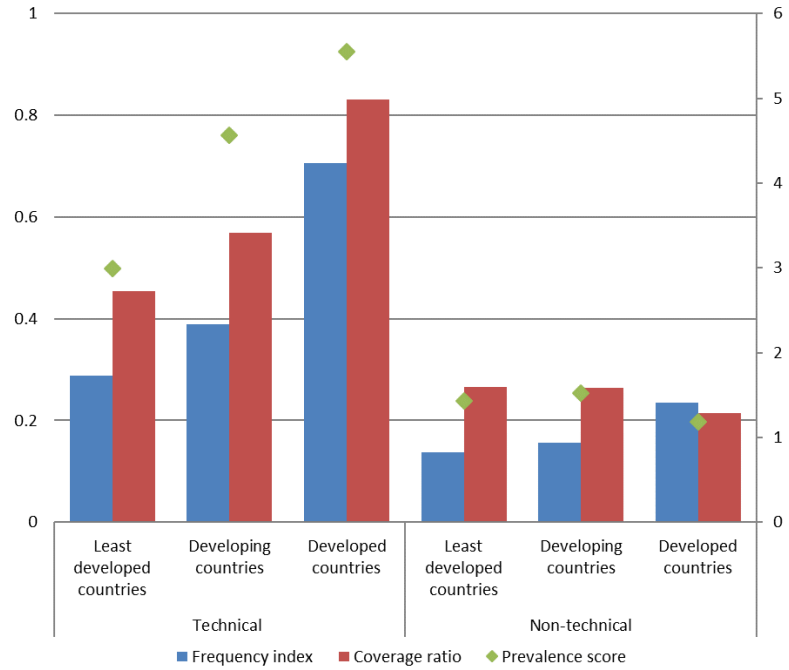
(a)



(b)



(c)



Source: UNCTAD calculations, based on the UNCTAD Trade Analysis and Information System database.

20. Costs related to non-tariff measures have a direct impact on firm productivity and are directly related to market access. Countries wishing to expand their export base need to carefully consider regulations prevailing in their export markets. Regulations often deal with product characteristics or production processes. The ability to gain reliable market access increasingly depends on compliance with regulatory trade measures beyond the realm of traditional trade policies. In other words, non-compliance with regulatory requirements effectively equates to an entrance ban. Non-tariff measures raise the level of investment needed to aim at export diversification into new products, disproportionally affecting the least developed countries and smaller companies and sometimes excluding them from markets. Recent research, including by UNCTAD, shows higher effective costs for such exporters. The high quality of sanitary conditions required, or the costly and sometimes unavailable world-class laboratories and certification and accreditation bodies required, marginalizes those with fewer resources. In such circumstances, for example in commodity-dependent developing countries, commodity dependence becomes a trap from which it is increasingly difficult to escape. In regional or global value chains, trade costs are passed on to the next production step, increasing the final consumer price. Costs are thus accumulated and also magnified through the steps in the production chain. If lower value added is produced in low-income developing countries, the impact is higher. Value added largely pays for the remuneration of employees and invested capital. Higher than average trade costs lower salaries and diminish investment. High costs in a global value chain node also impact productivity of the entire chain. Lowering the costs of trade on the import and export sides is in the interest of developing countries, as it lowers overall costs and improves the chances of participation in global value chains.[7]

21. Trade costs create an anti-export bias if they increase internal prices above world competitive prices. This occurs in small countries that are price takers. Policies such as duty drawbacks and export processing zones can compensate for additional trade costs only when inputs are imported, but disincentivize backward links that would enable an economy to further diversify and develop through domestic inter-industrial links that can bring deeper resilience to the economy. Higher profits can be achieved when accompanying policies foster the integration of business linkages attached to the production step participating in regional or global value chains. Enclave production schemes have little development impact. An open economy has to be able to produce high quality products in a competitive way to be able to fully integrate. The policies

[7] H Escaith, 2017, Accumulated trade costs and their impact on the development of domestic and international value chains, in: *Global Value Chain Development Report 2017*, World Bank, Washington, D.C.:97–117, available at https://ssrn.com/abstract=3045077.

needed are wide in scope, to impact the entire economy and enhance productivity. However, impacts may differ depending on the size of an economy and the exporting company. Not only are transnational companies more linked to global value chains than small and medium-sized enterprises, but non-tariff measures have a greater negative impact on smaller companies and in low-income countries.[8]

3. Private standards

22. Private standards, comprising product quality standards and characteristics demanded by value chain enterprises or retailers, are becoming important determinants of market entry. They do not originate from government regulations related to safety, health or technical concerns, but are based on the tastes and preferences of consumers in international markets. They are not enforced by law, by definition, but may nevertheless have impacts on market access similar to those of mandatory regulations. Private standards present challenges to exporters similar to those related to non-tariff measures. As with non-tariff measures and other government-imposed trade regulations, they are likely to be relatively costlier for firms in low-income countries to meet, particularly when certifications are required by third-party certifiers. This creates a wedge between large and highly productive firms that have the means to adopt private standards and small and less productive firms that may be left out of international markets. Private standards, like non-tariff measures, can therefore act as market access barriers, leading to lower levels of participation in global trade.

23. In this context, voluntary sustainability standards, a type of private standard, have emerged as instruments of value addition that respond to the growing demand for green products, thereby contributing to the achievement of the Sustainable Development Goals. The United Nations Forum on Sustainability Standards defines voluntary sustainability standards as "standards specifying requirements that producers, traders, manufacturers, retailers or service providers may be asked to meet, relating to a wide range of sustainability metrics, including respect for basic human rights, worker health and safety, the environmental impacts of production, community relations, land use planning and others".[9] Voluntary sustainability standards certification can enable producers to access niche green markets and associated price premiums, thereby providing economic incentives for firms to adopt production processes that are healthier and more respectful of workers, the environment and other socioeconomic objectives that consumers care about. This is horizontal qualitative diversification. The environmental or social requirement (and label) represents the added value in terms of environmental or social protection. As with technical non-tariff measures such as technical barriers to trade and sanitary and phytosanitary measures, voluntary sustainability standards address the quality and attributes of products, but they also set standards for production and processing methods. The majority of voluntary sustainability standards aim to reduce the potentially negative impacts of agroforestry and fishery or low-technology manufacturing with regard to local and global development challenges such as those related to child labour, better wages for primary-sector producers and biodiversity loss, among others. At present there are over 240 voluntary sustainability standards in more than 80 sectors in 180 countries.[10]

24. Voluntary sustainability standards redefine the framework under which value addition and diversification are conceived, establishing new priorities, constraints and requirements related to production processes and the use of resources. This new framework presents an opportunity to upgrade processes, yet can also exclude actors unable to adapt to it. Voluntary sustainability standards can act as market access barriers. A number of factors can make their adoption challenging, particularly for smallholder producers and microenterprises and small and medium-sized enterprises. This makes it difficult to determine whether the benefits of their adoption outweigh the potential unintended effects, an area requiring better assessment (box 3). Generally, the growing number and complex details of voluntary sustainability standards can create confusion among both producers and consumers and bifurcate markets across standards that are ostensibly equivalent. This has led to the emerging need to increase transparency and seek the mutual recognition and

[8] M Fugazza, M Olarreaga and C Ugarte, 2017, On the heterogeneous effects of non-tariff measures: Panel evidence from Peruvian firms, Research Paper No. 4, UNCTAD; M Murina and A Nicita, 2017, Trading with conditions: The effect of sanitary and phytosanitary measures on the agricultural exports from low-income countries, *The World Economy*, 40(1):168–181; UNCTAD, 2013, *Global Value Chains and Development: Investment and Value-added Trade in the Global Economy* (United Nations publication, Geneva); UNCTAD, 2014, *Study of Average Effects of Non-tariff Measures on Trade Imports* (United Nations publication, New York and Geneva); UNCTAD, 2016.

[9] United Nations Forum on Sustainability Standards, 2013, *Voluntary Sustainability Standards* (Geneva).

[10] United Nations Forum on Sustainability Standards, 2018, *Voluntary Sustainability Standards, Trade and Sustainable Development* (Geneva).

harmonization of voluntary sustainability standards across countries and labels. Partnership with the private sector is central to success.

Box 3
UNCTAD voluntary sustainability standards perception assessment toolkit

In practice, it has been difficult to quantitatively establish whether voluntary sustainability standards contribute to value addition and the improvement of living conditions in developing countries, mainly because the impact of their adoption on local producers is highly context specific. In addition, labelling and certification costs faced by low-income country producers can be high, whereby labelling may not necessarily increase welfare for certified producers even if they receive higher prices. The empirical literature suggests that prices, quality and worker welfare in certified firms are higher than in non-certified firms, yet it is not usually possible to establish the causal impact of certification due to limitations in data availability. This hinders public-sector policymaking in this area.

UNCTAD has therefore developed a voluntary sustainability standards perception assessment toolkit, to help policymakers detect areas in which policy could offset the unintended effects of voluntary sustainability standards in specific cases. The toolkit aims to assist users in systematically collecting data and fact-based information on the preparedness of different stakeholders to adopt such standards in specific agricultural value chains. The toolkit guides users in mapping the value chain of interest and identifying all relevant stakeholders for the completion of surveys using the proposed structured questionnaire and guidelines for open-ended questions. A guide to analysing the resulting data is also provided. The toolkit can shed light on the understanding and concerns of different stakeholders along a value chain that underlie the adoption of certification and sustainable production methods. For policymakers, the visualization of motivations can not only help identify power and perception asymmetries among value chain actors but also contribute to the detection of areas in which policy could play a role in mitigating the unintended effects of adopting voluntary sustainability standards.

Sources: J De Melo and M Olarreaga, forthcoming, Trade-related institutions and development, in: J-M Baland, F Bourguignon, J-P Platteau and T Verdier, eds., *The Handbook of Economic Development and Institutions*, Princeton University Press, Princeton, United States; UNCTAD.

III. Policy considerations

25. The participation of developing countries in the international trading system is affected by many factors, among the most important of which is their productive capacity for export and the access conditions faced in key markets. Promoting value addition and enhancing productive capacity, including through local economic empowerment, is a key perennial challenge. A typical challenge in adding value and boosting domestic productive capacity in developing countries is exemplified by experiences in commodity-dependent developing countries. UNCTAD analysis suggests that the following policies may be important with regard to adding value and enhancing productive capacity:

(a) Diversification requires a long-term coherent and integral strategy, with dedicated institutions at the national and regional levels. Success may require decades of sustained effort in terms of reforms and policies. Adding value requires knowledge, access to technology, infrastructure and other inputs that might not be available in a developing country. Policies in the areas of investment, services and competition may also be necessary. Developing countries therefore need to increase access to such enabling resources and bear in mind coherence policies to boost value addition and productive capacity;

(b) The type of diversification to be pursued must be carefully thought through, such as developing the production of non-traditional exports in both the agricultural and non-agricultural sectors. The selection of new sectors must be analysed together with the available capacity in a country, in order that priority in industrial policy may be given to those new products that employ the experiences, resources and services already available, over those that require greater initial investment. A combination of vertical and horizontal diversification may be used, as well as the pursuit of qualitative diversification in some instances;

(c) Human capital is key to any successful diversification strategy;

(d) Macroeconomic stability is an important factor in value addition and diversification, in particular exchange rate stability, as it can help a country expand its exports over time and stabilize its terms of trade.

26. Adding value implies that a country creates a new product for which it needs to find a market. Given the current configurations in international trade, tariff escalations and non-tariff barriers and measures may make it difficult for a developing country to penetrate markets governed by rules that differ from those applying to primary commodities. For example, exporting cocoa beans is substantially different from exporting cocoa powder or chocolate. To be successful, therefore, a diversification strategy based on value addition must be combined with or preceded by efforts related to market analysis, the understanding of consumer tastes, branding and marketing, the knowledge of tariff and non-tariff measures and the available conformity assessment capacities.

27. With regard to market access conditions posed by non-tariff measures and private standards, there are some important considerations. First, trade costs must be addressed. Policies aimed at lowering costs can enhance productivity and raise profits beyond break-even levels and thereby increase participation in production chains for some products that might otherwise be non-competitive. This may be achieved through the following actions:

(a) Implement good regulatory practices at the national level: tackle bureaucracy; review inconsistent or unclear regulations or incoherence in regulatory practices between different departments; avoid variability, such as unannounced or non-consulted regulations; and turn to international standards as much as possible, considering the acceptable risks in the country;

(b) Explore opportunities for regional cooperation. In general, cooperation in dealing with trade barriers between trading partners, in particular under regional integration, reduces the obstacles encountered by traders and allows for the consolidation of export diversification in new or emerging non-traditional exports. Industries linked within a region often have more value added and are more sophisticated; the potential for positive impacts on development, diversification and higher wages are therefore more easily uncovered in intraregional trade. Differences in regulatory schemes may raise costs. It may therefore be beneficial to address differences in requirements in home and partner countries through mutual recognition agreements or through harmonization in certain key sectors;

(c) Enhance transparency as a global good, including through the implementation of trade portals and the collection of non-tariff measures data. Transparency benefits in particular those that cannot afford to find information, particularly smaller companies and low-income countries, which are the most negatively affected by non-tariff measures.

28. Second, compliance costs must be addressed in a way that promotes the upgrading of productive capacity in the private sector and the quality and safety of the products to be exported. Non-tariff measures in most cases raise the price of inputs, yet may also reflect an increase in quality. Value addition may take place when a country is successful in complying with requirements in export markets. The following should be considered:

(a) Poor quality-control systems in developing countries often act as bottlenecks to the diversification of exports, as testing and certification by internationally accredited laboratories are often required for mandatory or voluntary conformity assessments and can be expensive;

(b) Compliance with required non-tariff measures enables access to profitable markets and the development of gainful business networks. In order to achieve this, productive capacity needs to be upgraded. Policies that favour overall competitiveness can also help improve export diversification, since businesses can become more competitive globally. Sectoral support may need to be provided by linking small producers, to achieve economies of scale. Promotion may require policies such as financing facilities for new investments in fixed costs before export consolidation;

(c) Engaging in regulatory consultations and standard setting with businesses can help ensure more successful partnerships. Regulations should not inhibit or constrain private endeavours, but provide guidance on cost-effective investments and learning curves, in order that as many private companies as possible become successful non-traditional exporters.

29. Finally, to minimize the market access difficulties posed by voluntary sustainability standards, and maximize their potential for value addition, Governments and international organizations may consider some of the following policy options:[11]

(a) Transparency: provide information on voluntary sustainability standards and their benefits, promote the involvement of stakeholders in the governance of such standards and facilitate comparability across standards;

(b) Partnerships: develop partnerships related to voluntary sustainability standards and their stakeholders to promote insights, build partnerships for capacity-building, develop new standards together with business and/or civil society and build platforms to promote coordination among standard setters and to stimulate the revision of processes related to such standards and ensure that any value created is not lost to international intermediaries;

(c) Economic incentives: provide tax exemptions or financial support for those seeking certification or committing to voluntary sustainability standards, benefit such standards in public procurement and financially support coordination platforms among standard setters;

(d) Legal matters: provide public accreditation for third-party monitors or organizations related to voluntary sustainability standards and the legal definition of institutional requirements for such standards.

30. In considering such policy options, two caveats should be kept in mind. First, the impact of voluntary sustainability standards on local producers is highly context specific, and policy options need to be carefully tailored to the value chains of interest. Second, to truly add value, standards need to be credible and to reflect the socioeconomic objectives demanded by markets.

[11] The options cited here are taken from the broader, more exhaustive, analysis of policy instruments aimed at influencing the trade effects of voluntary sustainability standards in United Nations Forum on Sustainability Standards, 2018.