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Third session
Geneva, 14–15 December 2015

Report of the Multi-year Expert Meeting on Enhancing the Enabling Economic Environment at All Levels in Support of Inclusive and Sustainable Development on its third session

Held at the Palais des Nations, Geneva, from 14 to 15 December 2015

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Introduction

1. The third session of the Multi-year Expert Meeting on Enhancing the Enabling Economic Environment at All Levels in Support of Inclusive and Sustainable Development was held at the Palais des Nations in Geneva, Switzerland, on 14 and 15 December 2015. The topic for this session was decided at the fifty-seventh executive session of the Trade and Development Board in June 2013. The session also covered the topics scheduled for the fourth session.

2. The meeting was composed of four sessions: the first three featured presentations by a panel of experts, followed by discussion by participating experts; the wrap-up session covered the outcomes of the first, second and third sessions of the multi-year expert meeting.

I. Chair's summary: Devising approaches to stimulating economic diversification and promoting value added production, including through investment, with a view to providing equal economic opportunity for all, particularly women and youth

(Agenda item 3)

A. Diversification and technological change: Linkages and strategies

3. Introducing the agenda item, the Director of the Division on Globalization and Development Strategy said that it was a timely moment to examine approaches to stimulating economic diversification. Diversification and structural change played an important role in boosting sustainability, generating employment opportunities, including for young people and women, and building resilience to external shocks. It also underlay many of the Sustainable Development Goals to which member States had committed. However there were major challenges to stimulating diversification in the current global economy, as evidenced by the middle-income trap and trends of de-industrialization or re-commodification that had been occurring in some countries. Historical experience from today's developed and developing countries showed that diversification, in particular industrialization, could not be left to the market alone. It required a framework of supportive policies, institutions and political choices that might be increasingly difficult to put together in the current context.

4. The panel of experts emphasized the continued importance of manufacturing in the diversification process. One expert said that knowledge, which was essential for development, was embodied in manufacturing-related physical and human capital. Even when countries chose to focus on service sector activities, success in these sectors still depended on the use of high value added manufacturing products. Similarly, all fast-growing emerging economies were characterized by a high level of manufacturing value added as a percentage of gross domestic product, significantly higher than the average of countries of the Organization for Economic Cooperation and Development.

5. The question of how to boost manufacturing and achieve diversification occupied much of the discussions. Traps could include taking only small steps in diversification into activities that remained closely related to commodity dependence (for example, moving into wine and salmon fishing but with the link to copper remaining too strong), or which were not contributing to production or productivity (for example, some financial activities).

In one speaker's view, while there was no single pathway to diversification, the establishment of a local production system with at least four types of multiple linkages – production, technological, consumption and fiscal – that created cumulative effects was essential.

6. Forward and backward production linkages were often missing in developing countries because there were few large domestic companies and few medium-sized companies, as in the United Republic of Tanzania. Technological linkages or their lack implied the extent to which intersectoral learning occurred; this in turn determined both the speed at which production or consumption investments would unfold and the direction of diversification. Rather than encouraging income increases to be diverted into imported goods, consumption linkages should be sought to help promote value added production locally. Fiscal linkages aimed at boosting fiscal capacity and enabling tax revenues to support productive investment were also desirable.

7. Useful examples of how policies could promote these linkages included the role of public technology intermediaries, including bureaux of standards and related facilities, and technology transfer offices. Country-specific examples included agriculture in the United States of America, the Brazilian firm Embrapa, the Chilean salmon industry and Fraunhofer in Germany. A lesson learned was that the effectiveness of any measures depended on the overall package in which they existed, as policies were interactive, and were combined and reinforced over time. Examples of industrial policy packages showed how individual policies needed to be seen as part of the whole. One expert gave examples of the use by some countries of fiscal policy to boost diversification, including a tax on exports of raw commodities in Kenya that stimulated the local leather industry, or on raw timber that boosted the plywood industry in Indonesia. Another expert noted that macroeconomic policy needed to be consistent with diversification and industrial policy strategies.

8. A major impediment to the technological change that underlay industrialization was financing – more than 40 out of 83 developing countries faced real lending rates higher than 7.5 per cent between 2000 and 2014, and there was limited interest from potential investors. Developed countries aimed to strengthen intellectual property rights because companies in those countries feared the spawning of competitors from the developing world. The new international discipline imposed by international investment and trade agreements made it difficult to build an indigenous enterprise sector, including those that were State related and private.

9. In the ensuing discussion, some delegates raised the issue of policy continuity. Economic policy needed to be consistent over a long period in order to achieve its purpose. In reality, however, policies were often affected by changes implemented by the government. For instance, in a new measure, the Brazilian Government had imposed fiscal discipline on public finance, which had prevented the pursuit of an industrial policy launched by the previous governments. Fiscal and monetary policies could work in different directions, making an industrial policy ineffective (for example, government stimulus but high interest rates). In addition, long-term capacity planning was key to developing an industrial policy. However, ministries of planning had been dismantled over the past two decades in many developing countries, and expertise was therefore lacking. Instead, the focus had been on the short term. To build momentum, one expert suggested that the issue be brought before the United Nations General Assembly to sensitize Heads of Government.

10. Some participants said that interventionist policies should be carefully calibrated in a globalized world, where investors and capital were particularly mobile. Because of a number of misalignments, the current economic order needed to move towards a new global order. For instance, exchange rates were the most important global prices and could either support or undermine diversification efforts. However, they were often misaligned

and created macroeconomic distortions. Hence the need for a new Bretton Woods system, whereby countries would compete on the basis of productivity; otherwise developing countries could not expect broad development prospects. The current trading system was not conducive to development; further, the development dimension should take centre stage in current and future trade negotiations.

B. Trade, economic diversification and development

11. The panel session focused on diversification and upgrading production in the context of trade. According to traditional trade theory, countries should specialize in areas where they held a comparative advantage defined by technological, factor endowments or productivity differences. However, empirical evidence showed that countries tended to diversify and then re-concentrate along their development trajectories. In developing countries, extensive diversification could play an important role in moving towards new products or destinations. Experience showed that East Asian countries had more successfully diversified for the last two decades. Recent developments in trade theory indicated how trade might increase product diversity. Causation could run from export diversification to productivity or vice versa. Diversification was associated with lower output volatility and better terms of trade, providing insulation from external shocks as well as opportunities for learning by exporting. There was some empirical evidence of a positive relationship between diversification, structural transformation and growth.

12. The success of East Asian countries was commonly associated with export-led growth but some countries had diversified without rapid export growth, and others had export-led growth without diversification. In most cases, diversification was accompanied by capital accumulation and took place through all tradable sectors, not only the export-oriented ones. It therefore made sense to focus on investment- and tradable sector-led growth, including through export-oriented and other activities. The key to diversification of trade and industrial structures would then be the expansion of the tradable sector, which tended to be more capital intensive than the non-tradable sector in developing countries. Thus the real exchange rate would assume a crucial role for growth, as it could influence the distribution of resources between tradable and non-tradable sectors. Real undervaluations might allow countries to gain permanent footholds in new sectors and induce firms to expand product and market space. Empirical evidence had shown that the real exchange rate was the most robust variable in explaining investment acceleration episodes and that undervaluations tended to be associated with product and partner trade diversification.

13. There was broad consensus among the experts on the need to link the macroeconomic and the microeconomic dimensions of trade. Fallacy of composition was a risk when many countries went down the same diversification path. There could also be distributional conflicts. In developing countries in particular, distortions in the tradable sector were greater, financial markets were less developed and resources could be employed at very low marginal cost – especially labour that was based on high unemployment. Further, most developing countries had made a relatively small footprint on international markets.

14. However, international trade was considered important for generating external demand and expanding markets, particularly for small countries. Exporting could ease balance of payments constraints and generate dynamic gains with regard to scale economies and specialized capabilities and provide learning opportunities. Economic growth was linked to a trajectory of profitability and productivity, upgrading and structural transformation. However, trade did not automatically translate into growth. What was important for developing countries was how they participated in the global economy, not

necessarily through liberalization, but in a way that led to structural transformation, increased value added and better employment. The focus should not be on static gains from trade, but rather from dynamic gains.

15. The nature of the global economy had changed in two dimensions over the past two decades. First, fragmentation and globalization of production had resulted in the growing importance of global value chains and trade in intermediates, with predominance in manufacturing, services and commodities. This had resulted from a change in the strategies employed by transnational corporations, as they focused more on core competencies, offshoring and outsourcing. Other contributing factors were the increased export orientation of developing countries, trade and investment liberalization, lower transport costs and advances in information and communication technologies. Global value chains enabled countries to specialize in certain activities and integrate into global markets, creating opportunities, but with significant limitations for upgrading and development. Second, changes in demand were related to the rise of emerging economies as new growth drivers and end markets, along with stagnating demand in developed countries. There was also an expansion of intraregional trade and increasing importance of local markets. Given that domestic demand was considered of particular relevance to large countries, there was a need to link internal and external trade.

16. The renewed focus on structural transformation and industrialization needed to go beyond manufacturing and should include services with increasing technological content. There was also potential for many developing countries in agro-processing and mining. For these countries, upgrading from these sectors was a good starting point. Most experts agreed it was important to establish forward and backward linkages. The fiscal linkage was crucial for the extractive industries. Some developing countries could find it easy to enter global value chains and diversify by engaging with lead firms. However, there was a risk of a race to the bottom and countries getting locked into low- and medium-technology manufactures, with declining terms of trade, or in assembly activities. This did not provide a basis for sustained income growth because the key was not just to participate in global value chains, but to upgrade production in the value chain. The potential of global value chains differed according to end markets with varying standard and upgrading possibilities. Moreover, lead firms tended to be large firms mostly located in developed countries. Developing countries were struggling to increase the size of their firms, particularly because of financial constraints, in order to better capture the benefits of global value chains.

17. There was broad agreement among participants about the key role played by policies and institutions at the international and national levels with regard to trade, industrial investment, labour markets, skills and infrastructure. In particular, the challenge of industrial policy for upgrading and increasing value added was the same in the era of global value chains. Different policies, including social policy, needed to work together in a complementary manner. Several participants highlighted the importance of an enabling international environment in support of diversification in developing countries. In this context, a number of experts stressed that developing countries should have sufficient policy space for development. Global value chains should be used selectively within a country´s development strategy, while regional value chains could be a basis for upgrading.

C. Industrial policy

18. The discussion focused on the scope and content of industrial policy both historically and in the context of current economic challenges. Some experts said that although there was less hostility today towards industrial policies among international financial institutions than during the Washington Consensus in the 1980s and 1990s, the

role that industrial policies played in almost all industrialized countries was systematically undervalued. Fully fledged industrial policies were associated with the recent development successes in East Asia, and also in the more remote past with the industrialization of advanced economies such as France, the United Kingdom of Great Britain and Northern Ireland and the United States. Some experts said that industrial policy was often misconstrued because some believed that it meant that the “State picked winners”.

19. The panel discussion that followed focused on key elements that helped capture the full meaning of industrial policy. One panellist defined industrial policy as a concerted and sustained effort by a State to change the productive structure, a main objective being to create an enabling environment for organizations that managed the economy effectively, including in the private sector. There was consensus among the experts that industrial policy was used to build linkages and that it generated structural transformation that led to growth and development. Industrial policy was a key tool used by developmental States that was necessary but not sufficient for catch-up development and should be coupled with supportive macroeconomic policies.

20. The panel discussed examples of how to generate linkages based on experiences in certain manufacturing sectors of Taiwan, Province of China (1980s) and Uruguay (2000s). The diverse mechanisms used in these examples could be easily replicated in other developing countries or at least utilized as a source of inspiration to design an industrial strategy.

21. A number of delegates and other participants stressed that industrialization, even when supported by active industrial policies, was a long process. Consistency and sustainability were key criteria for success. Because it could take some 10–15 years to successfully implement industrial policy, States would need to take a longer-term view in planning and assessment outcomes. In this context, industrial strategies should be engineered so as to be less dependent on political circumstances that could vary in the short term and should be built upon a strong, widely-shared political consensus. Therefore, they should be as inclusive as possible, especially by involving workers and firms. Several participants emphasized that the lack of political stability greatly hindered the viability of industrial policies in their countries.

22. Many experts acknowledged that it was difficult to design appropriate industrial policies and implement them. For example, States had to strike a balance between nurturing and disciplining industries, as evidenced by the successes of East Asian developmental States and the important role of sunset clauses in State support for industry. Many participants pointed to the difficulty of understanding value creation dynamics within the production system, which was a critical point in designing appropriate industrial policies. Many countries strove to strengthen particular firms or value chains, struggling to harness the social construction of competitive assets in ways that created and captured value. Lastly, some experts noted that developing countries were currently in a more volatile external economic environment, and although industrial policy fit into a long-term perspective, its related targets should be adjusted accordingly. Diversifying output and trade partners, as well as relying more on domestic demand, would help overcome these challenges.

23. Many participants considered the ongoing restriction of national policy space to be a major constraint to industrial policy. For most developing countries, the ratification of multilateral and bilateral trade agreements drastically narrowed the scope for industrial policies. Many measures that developed countries had used in the past to nurture infant industries or promote economic diversification were now out of reach. However there was still potential for using industrial policy in constructive ways: the challenge was to identify and implement these measures. One expert said that the justification for industrial policy could usefully shift from a narrow economic goal – industrialization for example – to

targeting social needs and priorities, including health, environmental sustainability and other social goods such as clean water. This would make it possible to build a broader social consensus around their design and implementation.

D. Expert meeting wrap-up

24. The UNCTAD secretariat presented the main findings of the three preceding sessions of the multi-year expert meeting held between April 2013 and December 2015, with a particular focus on policy measures and tools aimed at "enhancing the enabling economic environment at all levels in support of inclusive and sustainable development".

1. First session

25. The first session of expert meeting was held in Geneva, Switzerland, on 16 and 17 April 2013. The theme of the meeting was "Prospects for building resilience to external shocks and mitigating their impact on trade and development". One important deliberation addressed the sluggish performance of the developed economies, especially in Europe, and the repercussions of an environment of slow growth as a result of the interdependence of developing and developed economies. In the context of interdependence, the reduction of developing country vulnerabilities had become central to building resilience to external shocks. In the short term, the emphasis should be placed on countercyclical policies; in the long term, the diversification of supply and demand was essential. It was necessary to diversify demand in order to reduce the dependence on exports to developed economies, giving a larger role to domestic and regional markets.

26. The following conclusions could be drawn from the discussions of the meeting:

- The state of affairs of the world economy, characterized by sluggish growth and recession in the developed economies and the interdependence between developed and developing economies through finance and trade, was not a transitory state but reflected a structural crisis with long-term roots and implications. In such an integrated world, there was only limited scope for countries to insulate themselves against the direct and indirect effects of the global financial and economic crisis.
- Given the interdependence created by international trade, changing patterns of global demand had highlighted the disadvantages and vulnerabilities associated with the export-led growth strategies for developing countries. To build resilience to these vulnerabilities and risks, it would be advisable to use public policies and regulations that focused on technological change, international cooperation, multilateralism, capacity-building and the positioning of different economies in global value chains.
- The current stance of the international financial system generated instability for developing countries through cycles of boom and bust. Coping with this instability required re-thinking capital account liberalization and capital controls, debt crises and the roles of debtor and creditors, and prospects for monetary and financial stability.
- Timely and relevant statistics were essential to understand the fast-changing economic world and could help build resilience to external shocks. The contributions of the database UNCTADStat and the projects supported by UNCTAD, such as the Agricultural Market Information System, continued to help provide an understanding of the channels and sizes of shocks, and develop policies aimed at building resilience.

2. Second session

27. The second session of the expert meeting was held in Geneva, Switzerland, on 8 and 9 December 2014. The theme of the meeting was “Enabling the multilateral trading system for inclusive and sustainable development”. Discussions were centred on the following points:

- There had been an evolving contribution of trade to inclusive and sustainable development. Since trade would be a key component of the post-2015 development agenda, it was important to link trade policies with other development policies such as industrial policy. Such policies would need to reflect today’s realities, including the growth in trade along global value chains, volatile commodity prices, increased trade in services and growing South–South trade.
- The role of the multilateral trading system as a public good should be recognized, but to gain recognition, it needed to be inclusive and efficient. Therefore, the fundamental principles of the World Trade Organization, including those of inclusiveness and consensus in decision-making, remained valid.
- The discussions on the new regional trade architecture and the relationship between multilateral and regional trade agreements included the fragmentation of trade architecture and the risk that smaller countries might be left out.
- The way forward for strengthening the multilateral trading system should include several adaptation measures concerning issues such as currency misalignment and climate change.

3. Third session

28. The third session of the expert meeting was held in Geneva, Switzerland, on 14 and 15 December 2015. The theme of the meeting was “Devising approaches to stimulating economic diversification and promoting value added production, including through investment, with a view to providing equal economic opportunity for all, particularly women and youth”. The theme was closely linked to the topic of the *Trade and Development Report 2016*. The outcome of the meeting emphasized the following points:

- Diversification was still central to the development process, but it needed to be better understood, including by taking into account the types of linkages, technology, fiscal policy and the role of different sectors of the economy (industry versus services) in promoting productivity-enhancing structural change and development.
- What constituted an enabling international environment for development, diversification and growth in productivity, including how the rise of global value chains affected these relationships, were key elements to be furthered considered and better understood.
- The issue of policy space for developing countries under the current global economic environment was a common theme throughout the discussions. Despite growing constraints, countries could implement a variety of industrial policies to support development.
- There was a need to think of industrial policy in a broad sense, with consideration of macroeconomic trends and policies, trade policies and institutional frameworks.

II. Organizational matters

A. Election of officers

(Agenda item 1)

29. At its opening plenary, on 14 December 2015, the multi-year expert meeting elected Mr. Raphael Hermoso (Philippines) as its Chair and Ms. María Natalia Pacheco Rodríguez (Plurinational State of Bolivia) as its Vice-Chair-cum-Rapporteur.

B. Adoption of the agenda and organization of work

(Agenda item 2)

30. Also at its opening plenary, the multi-year expert meeting adopted the provisional agenda for the session contained in document TD/B/C.I/MEM.5/7. The agenda was thus as follows:

1. Election of officers
2. Adoption of the agenda and organization of work
3. Devising approaches to stimulating economic diversification and promoting value added production, including through investment, with a view to providing equal economic opportunity for all, particularly women and youth
4. Adoption of the report of the meeting

C. Outcome of the session

31. At its closing plenary, on 15 December 2015, the multi-year expert meeting agreed that the Chair should summarize the discussions.

D. Adoption of the report of the meeting

(Agenda item 4)

32. At its closing plenary, the multi-year expert meeting authorized the Vice-Chair-cum-Rapporteur, under the authority of the Chair, to finalize the report after the conclusion of the meeting.

Annex

Attendance[1]

1. Representatives from the following States members of UNCTAD attended the session:

Algeria	Indonesia
Argentina	Morocco
Burundi	Nepal
China	Pakistan
Côte d'Ivoire	Poland
Ecuador	Saudi Arabia
Egypt	Spain
Ethiopia	Thailand
France	Turkey
Greece	Uruguay
India	United States

2. The following intergovernmental organizations were represented at the session:

South Centre

3. The following United Nations organs, bodies and programmes were represented at the session:

International Trade Centre
United Nations Research Institute for Social Development

4. The following specialized agencies and related organizations were represented at the session:

Food and Agriculture Organization of the United Nations
International Labour Organization
International Telecommunication Union

5. The following non-governmental organizations were represented at the session:

General category

International Network for Standardization of Higher Education Degrees
World Vision International

[1] This attendance list contains registered participants. For the list of participants, see TD/B/C.I/MEM.5/INF.3.