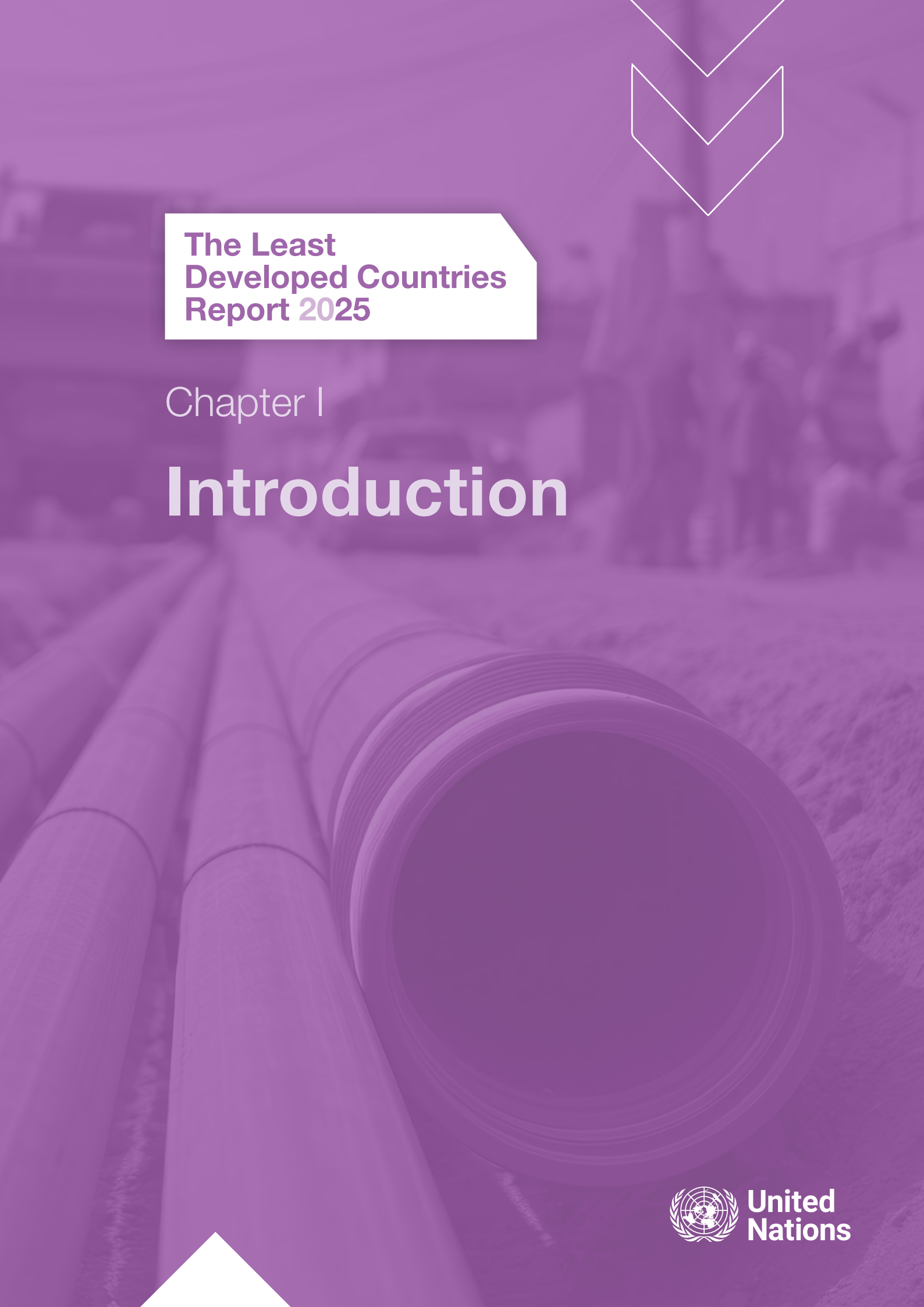
The Least Developed Countries Report 2025

Chapter I

Introduction



United Nations

From the start of the twenty-first century, the discourse on development and development policies has increasingly emphasized services as the main leverage for developing countries – including least developed countries (LDCs) – to accelerate their growth and development. This reasoning holds that a focus on strengthening and expanding different services sectors allows developing countries to transform the structure of their economies, modernize their productive activities, accelerate economic growth, and thereby achieve considerably higher levels of well-being. Such reasoning has accelerated, especially with the expansion of the digital economy.

For 250 years, in countries that have been successful in radically transforming their economies, industrialization has been the pathway to structural transformation, with the continuous expansion of higher value added sectors of economic activity, economic diversification and higher levels of income. More recently, however, industrialization has been questioned in terms of accessibility and even desirability. The are several reasons for this, as recalled below.

First, on a global scale, technological change has rendered manufacturing more capital- and skill-intensive, with plants requiring larger scales to be economically viable (UNCTAD, 2024; Rodrik, 2014). On one side, this raises barriers to entry by new operators and producers, whether companies or countries. The intensifying use of robots and digital technologies tends to attenuate the job-creating potential of manufacturing and the sector's capacity to absorb excess labour (typically low-skilled) being freed in agriculture (UNCTAD, 2016, 2017a; Hallward-Driemeier and Nayyar, 2018). At the same time, rising capital intensity and automation significantly weaken a comparative advantage of developing countries – and especially LDCs – which has traditionally been their labour costs (UNCTAD, 2003).

Second (and partly related to these major developments), manufacturing has become increasingly concentrated in a few countries, especially China and India (UNIDO, 2024).

Third, in a context of globalization, these technological and economic developments have led to heightened worldwide competition in goods markets, whether international markets (where developing countries' industries are competing to place exports) or domestic ones (where domestic producers are confronted with heightened import competition).

Fourth, traditional industrialization has led to environmental degradation on both a local and global scale, due to factories' large-scale emission of pollutants and greenhouse gases leading to degradation of air, soil and water (UNCTAD, 2021a, 2021b, 2024; UK Aid and UNCTAD, 2020; Edeme et al., 2024; Hodu Ngangnchi et al., 2024). This has produced adverse consequences for human health and environmental quality (Intergovernmental Panel on Climate Change, 2022; The Lancet Commission on Pollution and Health, 2022).

The consequences of these developments are that entry barriers into manufacturing for latecomer countries have become considerably higher and industrialization has become an increasingly difficult route for latecomer countries to follow in their quest for structural transformation. Manufacturing export-led growth, which was the route taken by most successful industrializers in the twentieth century, is seen as an increasingly difficult – if not impossible – path to follow (Baldwin, 2024a). By the same token, it is argued that traditional industrial policies are no longer effective, realistic or worth pursuing (UNCTAD, 2024; Bartelme et al., 2025; Irwin, 2023; McKenzie, 2023; Altenburg, 2013).

Under these circumstances, the new thinking suggests low-income countries – including LDCs – to concentrate their efforts on services and attenuate or even forsake the struggle for industrialization (World Bank and WTO, 2023; Nayyar et al., 2021; Baldwin and Forslid, 2023).

Industrialization long drove transformation, **but rising costs, automation and competition now challenge its feasibility**

Digital technologies enable developing countries **to join global service value chains and transform economies**

These are seen as the feasible and realistic alternative for latecomer countries to follow in order to achieve their ultimate development goals (UNCTAD, 2017b). The arguments given for this alterative development path – and attendant policies – are manifold, as briefly summarized below:

- Services have collectively become the largest sector of economic activity worldwide, since at present they account for some two thirds of world output. In the same vein, services have become the largest generator of jobs globally.
- Services are the sector where the most dynamic forms of structural transformation is happening in the more advanced economies and, increasingly, also in developing economies (UNCTAD, 2017b, 2017c, 2019; Monga and Lin, 2019).
- Manufacturing-led export growth is declining, while services-led export growth is booming, in both lower-middle-income and upper-middle-income countries (UNCTAD, 2024; Baldwin, 2024b).
- Services are the main destination of global flows of foreign direct investment (FDI) (UNCTAD, 2025).
- Services have become the most dynamic segment of international trade, expanding at a faster pace than that of goods since the late twentieth century. This presents developing countries with opportunities for raising their exports and reaping the benefits traditionally associated with greater integration into international trade (WTO, 2019).
- The services sector is presented as having lower entry barriers to new countries, companies and even individuals that emerge in the market, as it has lower capital costs, lower infrastructure requirements (e.g. in terms of transport and energy) and lower skills requirements as compared with typical manufacturing plants. Therefore, in developing countries, micro, small and medium-sized services enterprises start exporting earlier than manufacturing firms (WTO, 2019).
- Services overall, or at least several services sectors, present some of the development potentials previously associated with manufacturing, especially the capacity to generate a large number of jobs (and thus absorb excess labour freed from agriculture).
- The more modern services sectors quickly incorporate technological advances and therefore contribute to increases in overall labour productivity, and act as a hub for technology diffusion throughout the economy, through backward and forward linkages with other economic sectors (manufacturing and agriculture, as well as among different service subsectors). Therefore, services can be a lever for technology diffusion, and overall economic growth and development, analogous to the role that manufacturing had played in traditional industrialization experiences (UNCTAD, 2017b, 2017a).

The surge and diffusion of a new generation of general-purpose technologies – including Internet, cloud computing and artificial intelligence – have brought about the emergence of the digital economy (UNCTAD, 2017a). It has transformed the services economy and opened up considerably wider possibilities for enhanced international trade in services. The new development thinking argues that developing countries can connect to global services/digital value chains and achieve a new type of structural transformation. The basis for this is that the emergence of the digital economy has multiplied the economic impact of services, especially through the following mechanisms:

- Technological changes have significantly expanded the tradability of different types of services which traditionally had been considered as non-tradable (WTO, 2019). They have lowered

costs, expanded modes of supply and delivery, and lowered barriers to participation in international trade.

- The global diffusion of these new technologies has significantly reduced technological barriers to international trade in services, especially intermediate services. There is great demand for these services in developed countries, which opens space for emerging exporters, including those in developing countries (UNCTAD, 2017b, 2017a; Baldwin, 2024b).
- The new technological configuration has broadened the scope of sales and export markets to a virtually global scale, thereby obviating the traditional challenges of limited domestic markets to generate economies of scale. Consequently, emerging operators or suppliers have become economically viable (UNCTAD, 2017a; WTO, 2019).
- Service export-led growth is the development strategy that an increasing number of developing countries have taken, and this represents the way forward for most developing countries, including LDCs (UNCTAD, 2017b, 2024; Baldwin, 2024a).

Beyond global trends, the new recommendations given to low-income developing countries – including LDCs – are also in line with structural change trends that are actually taking place in LDCs. A few of these countries have followed a path that to some extent resembles the classical industrialization route, where a significant part of the rural exodus of the workforce has been absorbed by a growing manufacturing sector. This has been the case – to a certain extent – in some Asian LDCs (such as Bangladesh, Cambodia, Myanmar and Nepal). However, the majority of LDCs have undergone "premature de-industrialization" or even "pre-industrial deindustrialization" (Rodrik, 2016; Tregenna, 2015, 2016), as the share of manufacturing in both employment and output has declined, even though these countries had not previously experienced meaningful industrialization, in a process that took place at low levels of income and development. In these countries, the major process of structural transformation has been excess labour freed by agriculture being absorbed by the urban tertiary sector. This has been a new pattern of structural transformation, quite distinct from the traditional one (UNCTAD, 2014, 2020; Sen, 2023).

The policy implication of this collective reasoning is that LDC Governments and their development partners should view the services sector – and especially digital development – as a priority pillar of economic policy. The priorities would then be for LDCs to liberalize trade in services internationally; modernize their domestic regulatory frameworks for services sectors, so as to adapt them to ongoing global economic and technological evolutions; align with international regulatory standards; target digital skills development; and broaden connectivity (UNCTAD, 2017b, 2017a; World Bank and WTO, 2023).

In spite of the enthusiasm generated in international policymaking circles by this new approach of development thinking, there is no agreement on this proposed direction for development policies and strategies. Critically, the reasoning and policy thinking exposed above seem to suffer from some shortcomings.

First, the reasoning often extrapolates trends from developed countries or more advanced developing economies to countries at the lower rungs of development. Therefore, it does not adequately take into account that structural conditions are markedly different in LDCs, in terms of capital and skills endowments, infrastructure, sectoral composition of productive sectors, etc.

Second, although there is undoubtedly a new pattern of structural transformation taking place in most LDCs, it does not necessarily mean that it is the most conducive to these countries' reaching their development goals, as attested by the very mixed growth and development record of this group of countries since the establishment of the LDC category (UNCTAD, 2021c).

Most LDCs face premature de-industrialization, with labour **shifting from agriculture to low-productivity services instead of manufacturing**

Third, debates and policy discourses often present the services sector as a bloc and therefore do not make the necessary differentiation required by the strong heterogeneity of the services sector, both within countries and among them. This diversity means that the technology and skill intensity of different services (sub) sectors, and their growth and development potential, vary significantly within and among countries at different levels of development.

Therefore, the rationale, arguments and evidence presented by the new development thinking must be critically examined in the light of the specific structural conditions of LDC economies and of these countries' developmental needs. The objective of *The Least Developed Countries Report 2025* is to unpack the reasoning behind the arguments for the reorientation of development strategies, and analyse the current state and recent trends of the services economy in LDCs. This enables a critical assessment of whether the conditions for the emergence of services sectors represent a sufficiently powerful lever for the structural transformation of their economies, which, as *The Least Developed Countries Report* series has long argued, is a sine qua non for them to reach their development goals (e.g. UNCTAD, 2014, 2021c). The present report draws on evidence informed by the performance, strengths and limitations in LDC economies, with a view to helping policymakers in LDCs and in their development partners gauge the real opportunities and navigate potential pitfalls of a radical policy shift in favour of services.

To answer this line of questioning, the report starts by highlighting the performance of the services sector in meeting the dual challenge of generating more and better jobs and accelerating productivity growth in LDCs. It shows that there are strong complementarities and synergies between services and industry, but that so far services have been a residual absorber of labour rather than a dynamic engine of productivity growth in LDCs (chapter II).

The report then analyses the patterns of trade in services of LDCs. It shows that these countries' exports are strongly concentrated in traditional sectors that are related to tourism, such as travel and transport. At the same time, it provides evidence that LDCs largely missed the global surge in international trade in the more modern and dynamic sector of business services and knowledge-intensive services, including digitally-delivered services (chapter III).

The report then presents a series of case studies which reveal how several LDC Governments have targeted specific service sectors (finance, tourism, logistics and transport), hoping that these sectors can leverage the structural transformation of national economies. These strategies are having different degrees of success and developmental impact, and they incur risks, of which policymakers need to be aware of (chapter IV).

The report concludes by recalling the overall lessons of the analysis and distilling policy priorities that are most likely to accelerate the structural transformation of LDCs (chapter V). There is not a choice between services and industry; rather, they need to be developed in tandem and the services sector needs to develop broad and deep linkages with other economic sectors (such as agriculture and industry), as well as among different services subsectors. This requires broad-based development policies and clear industrial policies to guide the process. Having the services sector well embedded into the national economy is the basis for expanding exports, by reaping existing opportunities in international markets. This in turn requires actively engaging in international trade negotiations at the bilateral, regional, continental and multilateral levels. LDC development partners need to support LDCs in this trajectory, not only by widening their market access in a meaningful way, but especially by providing much more proactive and decisive support to LDC service producers' developing and upgrading their productive capacities.

The report finds that services absorb labour but lack productivity dynamism, **offering limited support for structural transformation in LDCs**

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