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**Session I: Achieving structural transformation and economic growth in LDCs: challenges and
opportunities - 12 July 2018**

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The least developed countries experienced an impressive acceleration in their rates of economic growth during the first decade of the 21st century, reaching a rhythm of growth unseen for over 30 years. This put the question of how sustainable it was and, by the same token, whether strong economic growth was accompanied by the structural transformation of LDC economies. Our analysis shows that economic growth was actually accompanied by some type of structural transformation, but the latter has taken diverse directions in different countries. Therefore, it has not always been conducive to progress towards development goals to the same extent in all LDCs.

Structural transformation is an enabler of accelerating LDCs' advancement towards IPoA targets and SDGs if it results from the transfer of productive resources such as labour, capital and land to more productive and higher value-added economic activities. This takes place through two parallel processes. First, increasing productivity within sectors thanks to technological improvements. Second, shifting productive resources from less productive to more productive sectors and activities. The resulting type of structural transformation can be qualified a "virtuous", because it leads to socially and economically desirable outcomes. It generates higher earnings to the population and hence better living conditions, better social outcomes such as health and education, and more diversified and higher value added exports. Structural transformation of the virtuous type also is also conducive to fulfilling the environmental dimension of sustainable development.

However, in some cases productive resources like labour, capital and land are transferred to other similarly low-value-added and low-productivity activities. In these cases, some form of structural transformation is going on, but not of the type which is most conducive to sustainable development. In these cases, typically there is some increase in labour productivity accompanied by economic growth, but not enough to strongly accelerate countries' progress towards the IPoA goals and the SDGs.

Over the last 20 years structural transformation has proceeded quite differently among LDC groups. Most Asian LDCs have followed a classical transformation path. The share of the primary sector – i.e. agriculture and mining – declined sharply from 38% of GDP to 24% of GDP over the 20 years to 2016. Concomitantly, these countries reduced their dependency on commodities for the generation of exports. The primary sector used to generate half of their merchandise exports 20 years ago, while now it accounts for just one fourth of total exports. At the same time, Asian LDCs have progressed in the path of industrialization. The manufacturing share of GDP rose from 12% to 17% over the last 20 years and manufactures now account for three fourths of Asia LDC merchandise exports.

The strong capacity of labour-intensive manufacturing to generate jobs has meant a rapid expansion of industrial employment and an accelerated reduction of poverty. It has also been accompanied by

improvements in economic and social development. It is therefore not surprising that Asian LDCs have been the group of LDCs which has made the most progress towards graduation from the LDC status, if one leaves aside the case of SIDS, which tend to graduate more quickly, but while remaining highly vulnerable. Moreover, for the first time two countries have met the three LDC graduation criteria at the same time, and these have been Asian LDCs: Bangladesh and Myanmar. This reflects the broad-based progress brought about by virtuous structural transformation.

In the group of African LDCs and Haiti, by contrast, the patterns of structural transformation were strongly influenced by the latest so-called commodity super-cycle. It rekindled investments in the primary sector while international prices spiked. Therefore, at the outbreak of the great global financial and economic crisis in 2008 the primary sector generated 45% of all economic activity in those countries. Since then it has receded due to the fall in commodity prices, but the primary sector still accounts for 37% of the group's GDP. African LDCs and Haiti continue to be highly dependent on commodities, which account for as much as 90% of their merchandise exports, unchanged from 20 years ago. This leaves these countries very vulnerable to the vagaries and fluctuations of international commodity markets. Manufacturing accounts for just 8% of the group's GDP, unchanged from 20 years ago, and the sector generates less than 10% of the group's merchandise exports.

In many of these LDCs urbanization has proceeded unabated over the last 20 years. However, given the low level of industrial development, manufacturing has not been able to generate the jobs necessary to absorb the population migrating from rural areas to cities. Therefore, the new urban dwellers have often taken refuge in the informal service sector (e.g. street retail trade, catering, personal services, etc.). While here labour productivity is slightly higher than in agriculture, it is well below that of manufacturing, as show in UNCTAD's *LDC Report 2014: Growth with structural transformation*. This pattern of structural transformation has meant that African LDCs and Haiti have generally not been able to generate the quantity and quality of jobs required to strongly reduce poverty. Therefore, poverty reduction has been slow and followed a path which is not compatible with its eradication by 2030, foreseen by SDG 1. Similarly, progress towards other development goals has typically been slower in African LDCs and Haiti.

Island LDCs have undergone a type of structural transformation that puts them closer to African LDCs than to Asian ones. Agriculture, fishing and mining contribute almost half of their combined GDP, a higher share than 20 years ago. Commodities account for over 90% of merchandise exports, a share similar to that of African LDCs. Surprisingly, the services sector accounts for the lowest share of GDP among LDC groups: 43%, as compared with 46% in African LDCs and Haiti and 52% in Asian LDCs.

The contrasting trajectories of structural transformation among LDC groups is reflected in the level of diversification of their merchandise exports. 20 years ago, Asian and African LDCs had equivalent levels of export diversification. Since then the former have diversified to reach a level of 73 the Export Diversification Index, which goes from 0 to 100. At the same time, African LDCs and Haiti have seen their exports become more concentrated and their export diversification index fall to 62. Island LDCs have a still less diversified pattern of exports, as their diversification index is just 44.

There is a strong association between the type and pace of structural transformation and progress towards IPoA goals and SDGs. When structural transformation goes in the desirable direction of development of higher value-added and higher-productivity sectors and economic activities, this sets a solid base for broad-based economic, social and environmental development and, therefore, for progress towards development goals.

Given the contrasting rhythm and direction of structural transformation I have just outlined, the question is what are the strategies and policies which LDCs and their development partners should put in place. These should have to goals: first, orient structural transformation in the socially and economically desirable direction and, second, accelerate progress towards development goals.

UNCTAD's *LDC Report 2014* singles out the following priority action areas.

First, resource mobilization requires a strategic and selective approach to domestic investment and foreign direct investment (FDI). Domestic investment has the advantages of having stronger backward and forward linkages, generating more jobs per investment expenditure and having greater reinvested profits. FDI has an important role to play especially where access to foreign markets and technologies is important. At the same time, the development impact of official development assistance (ODA) can be boosted through labour-intensive methods and local procurement in infrastructure investment.

Public investment has a crucial role to play in accelerating the structural transformation of LDCs, both on its own and as a catalyzer of private investment. This role is especially important in the fields of human skills development and of infrastructure building and operation, including in the areas of transport, ICTs and water.

Public investment and policies are equally important for LDCs to reach what UNCTAD's *LDC Report 2017* calls "transformational energy access". It means meeting producers' energy needs in terms of accessibility, scale, reliability, economic viability, affordability and efficiency. Producers are here understood in their broadest sense, including those in industry, agriculture, transport and services. For them, this type of energy access is a pre-condition for the development of their productive capacities.

At present, LDCs account for only one in eight people in the world, but more than half of the people are without access to electricity. On the productive sphere, lack of access to electricity is a serious obstacle to development. Across LDCs as a whole, 42% of enterprises identify electricity supply as a major constraint and LDC enterprises suffer an average of ten power outages per month, lasting an average of five hours, costing them on average 7% of the value of their sales. Electricity for productive use can transform the economies of LDCs. It can increase productivity, and allow new products and production technologies. Productive use of electricity can also help to provide the demand needed for investments in electricity infrastructure to be viable, both directly and by generating additional incomes.

Transformational energy access is therefore not just about meeting basic household needs. Rather, access to this type of energy is a sine qua non of both structural transformation and of most other economic, social and environmental development goals.

Second, industrial policy should follow a dual track, developing sectors of current comparative advantage, while at the same time anticipating and promoting changes in comparative advantage. This policy area needs to have very strong synergies and integration with two other types of policies. First, science, technology and innovation policies. Second, entrepreneurship policies. Entrepreneurship of the "right" type is required to play the role of motor towards sustainable development, as will be show in UNCTAD's *LDC Report 2018*, to be launched later in November.

Third, macroeconomic policies should support resource mobilization and industrial policies, by ensuring credit for productive investment and strong and steady demand growth.

Fourth, rural development is fundamental both to structural transformation in LDCs and to poverty eradication, as shown in UNCTAD's *LDC Report 2015: Transforming Rural Economies*. Two thirds of the population of LDCs live and work in rural areas. Moreover, that is where 82 per cent of those without access to electricity live. Structural transformation in LDCs therefore needs to have rural transformation as a starting point.

Rural transformation has to encompass agricultural upgrading and diversification towards rural non-farm activities, and to maximize the synergies between the two; and it needs to foster an increase in rural demand while strengthening supply response. The infrastructure investment needed to achieve the SDGs has a strong potential to generate increased rural demand. Therefore, it is important to have appropriate sequencing and design, including labour-based construction methods and local procurement, to maximize its transformational effect. There are strong complementarities between agricultural upgrading and rural economic diversification. Rural electrification can be a major engine of rural development.

Fifth, for the SDGs and the IPoA goals to be reached, they need to include **international measures** as ambitious as the goals themselves, to ensure a global economic environment conducive to LDCs' development in terms of aid, trade, finance and technology flows. The international community, having adopted the IPoA and the SDGs, need to show the necessary political will in providing the means necessary to their fulfilment. This includes providing LDCs with a level of ODA commensurate with the major challenges they face in meeting the SDGs. If donors met the target of 0.15-0.20% of gross national income (GNI) in ODA to LDCs, this would generate an additional \$33-53 billion per year, which could be used to accelerate investment in structural transformation. Additionally, meeting the long-standing target of 0.7% for total ODA and devoting half to LDCs would provide an additional \$118 billion per year. Developed countries could also make a major contribution by fulfilling their obligations on technology transfer under the WTO TRIPs Agreement and the United Nations Framework Convention on Climate Change. LDC efforts thus need to be supported and complemented by additional efforts by the international community.