Trade and Investment as Opportunities for Sustainable Growth in Developing Countries: Assessing the European Report on Development 2013

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The Report

**Relevant objectives:** post-2015 trade and investment policies: helping LICs-LDCs gain productive capacity, achieve structural transformation.

- Indeed, these are the lessons of fast-growing, typically Asian, economies=> for poorest economies, change in the structure of trade and investment – Global Value Chains/GVCs, investment policies.

- **Relevant analysis of EU trade and investment policies conducted so far:**
  - Positive reform of EU-GSP
  - EPAs: mixed results for ACP countries.
  - Weaknesses in EU commodity policy regarding countries vulnerable to shocks
  - Disappointing impacts of EU investment policies, new FTAs

- **Relevant post-2015 agenda:**
  - Promoting modern-sector exports (trade preferences; trade facilitation; policy dialogue)
  - Reducing vulnerabilities to external shocks (targeted interventions; reducing price volatility; effective and responsive global shock facilities)
  - Enhancing productive investments (using Aid for Trade to address binding constraints; investing in inclusive and sustainable development)
  - Improving global coordination on investment policy.
However, is it enough? Many deep, long-term, structural constraints
Three questions and challenges.

1. Many uncertainties, for 2015 and beyond…

- World Bank Report (2013): **positive processes**: since 2000, a shift in global investment toward developing countries, a shift toward greater manufacturing investment, and redistribution of capital toward developing countries. Global manufacturing investment is concentrated in lower-middle-income countries (mostly from China).

- But **investment patterns differ across countries**: low-income countries in agriculture, middle-income countries in manufacturing and services. Also, **investment booms are not always associated with sustained growth**.

- A new challenge: the EU-US free trade agreement…

- **Role of GVCs**: hence challenges of **chain reactions**: notably from emerging countries, Asian drivers, **China**. Challenge of the rebalancing of China’s economy, its slower growth in the medium term (Eichengreen et al., 2011)

- This reinforces the **great uncertainties on the level of commodity prices** (e.g., oil), on price co-movements across commodities, and on the existence or persistence of a ‘supercycle’ since the mid-2000s. The price of ‘hard commodities’ may drop sharply (aluminium, copper, iron ore).
Hence great **uncertainties on trade and investment at the global level** (Huang, 2013).

But **positive side**: developing countries that rely for growth on manufacturing will benefit, due to the increase of China’s unit-labour costs (Pettis, 2013).

- **Investment policies**: Baldwin (2011): ambiguous effects of bilateral investment agreements, e.g., fragmentation, bilateral interests motives, ‘spaghetti bowl’ effects.

- Poorest countries’ export structure: **dependence on commodities and their volatile prices** => **structural vulnerability** (Nissanke, 2011; Nissanke and Kuleshov, 2013). Very **narrow industrial bases**.

- Emerging countries’ investment in LICs: **ambiguous effects** (Sindzingre, 2013).

- **Negative prospects**: trade **mostly in the commodity sector**. Same for investment: e.g., ‘commodity-for infrastructure’ => strengthening the specialisation in commodities, lock-in effects (e.g., ‘Angola mode’, little local linkages, Corkin, 2011).

- **But positive prospects, if**: if commodity prices remain high, if the ‘supercycle’ is confirmed, if growth and demand from emerging countries remain high, if domestic institutions can harness these windfall gains => **spillover and industrialisation effects generated by commodity sectors** (Morris, Kaplinsky, Kaplan, 2011; 2012).

- Positive effects of emerging countries’ investment in manufactures, infrastructure: **positive impact of infrastructure on growth** (Estache, 2007).
Example of Sub-Saharan Africa: exports to developed and emerging countries are broadly similar.

Hence, contribution of emerging countries to structural transformation: modest hopes in the short–term

Source: UNCTAD Statistics: http://unctadstat.unctad.org
**Structural issues: possibilities of convergence?**

In contrast with theories of catching-up: divergence across ‘clubs of convergence’
Possibility of multiple equilibria and ‘traps’ (Azariadis and Stachurski, 2005).

**Divergence across regions: 1820-2000**

![GDP per capita, Sub-Saharan Africa vs. the world, 1960–2011](source)

Source: Galor (2012).

Convergence gaps have increased

Rodrik (2011): the potential for catch-up growth remains huge, especially in Latin America and Africa where the convergence gap is wider than before the 1990s.

Convergence gaps by region, 1950-2008 (difference in income levels, as percent of developed country incomes)

A structural issue: middle-income traps?
Characteristics of low income countries and middle income countries increasingly differ. Also, low-income countries may catch up, but transition from middle-income to higher incomes looks like a threshold...(Eichengreen et al., 2013).

Also, LICs-LDCs upgrading to middle-income countries: risks of an upgrading that relies only on short-term, volatile factors, e.g. commodity prices

Difficult middle-income transitions

Long-term forces of convergence, or divergence?
Relative vs. absolute perspective

Share of exports in world exports by region, 1948-2011 (percent)

Source: UNCTAD Statistics: http://unctadstat.unctad.org
Structural issues: the case of Sub-Saharan Africa

10 Sub-Saharan countries have commodities exports making over 75% of total exports

Sub-Saharan Africa: resources export as % of total exports

Hence structural problems for Sub-Saharan African trade over the long-term

Sub-Saharan Africa’s exports: percentage of world exports (right axis) and value (left axis), 1948-2011

Commodity dependence => impact of commodity prices volatility on GDP growth rates: hence weak impact of domestic policies on growth rates, in particular trade and investment policies.

Does growth stems just from ‘good luck’ – e.g., vis-à-vis external shocks - , or from ‘good policies’? (Easterly et al., 1993)

Most SSA countries=oil importers: 1973-78: oil shock. From the mid-2000s onwards, boom in commodity prices and co-movements energy and non-fuel prices (Baffes and Haniotis, 2010).


**Sub-Saharan Africa: growth rate (right scale) and commodity prices (annual price index, 2005=100, real 2005 dollars, left scale), 1960-2012**

Vulnerability of commodity-dependent countries: dependence of their revenues on commodities with volatile prices.
Confirmed by the impact of the financial crisis...
In oil-rich countries, government revenues from natural resources = 60% of total government revenues in 2011.

Government revenue from natural resources, 2011 (% general government revenue)

The fiscal vulnerability of commodity exporters, e.g. to the 2008 crisis shock

Negative impact of volatility on growth

Hence the questions: Which EU policies could overcome the structural negative effects of commodity-based market structures? E.g., Dutch disease, poverty traps, negative impacts of volatility on growth.

Which EU policies for high commodity prices and emerging countries’ demand to be an opportunity for sustainable growth in developing countries?

Growth and share of natural resources in merchandise exports

Growth volatility and GDP per capita

Source: Van der Ploeg (2011).

Source: Van der Ploeg and Poelhekke (2009).
2. Challenges for EU policies: structural transformation

- **What is structural transformation? Rise in productivity, export sophistication:** Hausmann et al. (2007) concept of ‘product space’
- **But many constraints on sophistication, and more for commodity-based export structures** (Rodrik, 2011).
- Difficulty of policies improving productivity in commodity-dependent LICs: paradox of high prices as incentives for remaining in the export of commodities
- MacMillan and Rodrik (2011): structural transformation is not always growth-enhancing: possible sectoral shifts, e.g., of workers to lower productivity sectors.
- Lessons of fast growing Asian ‘developmental’ states: successful shifts from agriculture to industry (Thorbecke and Wan, 2004), infrastructure and taxation.
- **Structural challenges stemming from the quality of growth, and demography:** some countries in commodity and aid dependence trap - not others (e.g., premises of industrialisation in LICs, e.g. Ethiopia). But little structural transformation in most SSA countries, unlike better-performing developing countries, due to population growth rates and low economy-wide growth (Binswanger, 2012). Little improvement in export sophistication, e.g. in a crucial sector such as agriculture (Badiane, 2012).
- **Can EU trade and investment policies enhance productivity and industrialisation?**
3. Challenges for ‘developmental’ trade and investment policies

- Strengthening the capacity of states of devising and implementing policies
- At low levels of development, ways of triggering virtuous circles: spillover effects (Rosenstein-Rodan, 1943); linkages (Hirschman, 1958), complementarities and increasing returns (Matsuyama, 1991).
- Lessons from ‘developmental states’, including China: strong support by states, capacity to implement trade and investment policies, planned, targeted, e.g. tax policies, technology transfers: EU policies may be the most relevant, they are challenged by weak state capacity in LICs.
- Fast-growing Asian states: state intervention is necessary in order to address coordination, information and market failures, externalities, uncertainty, which generate status quo bias for investors (Fernandez and Rodrik, 1991) and prevent risk-taking, hence firm creation. Only the state is able to address the possibility of multiple (low) equilibria, self-enforcing trapping processes typical of commodity-dependent LICs.
- How can EU policies strengthen state capacity, support the design and implementation of public policies, in particular industrial policies - technology, infrastructure and macroeconomic policies - e.g., targeting firms’ growth, not only in manufacturing but also in the agribusiness sector (Badiane, 2012).
4. Conclusion: outcomes as results from combinations

- Causalities result from interactions, not elements in isolation
- Diversity of the category of ‘developing countries’
- Diversity of possible policies, and domains of relevance – trade, investment…-, e.g. aid for trade, trade preferences…..
- =>additional challenges for EU policies

- The Report shows the relevance of trade preferences: allowing for genuine EU policies, and less exposed to well-known problems of financial facilities (e.g., no risk of fungibility stemming from pure financial support, no risk of leakages of funds).

- Diversity of the impacts of EU policies: no ‘one size fits all’: depending on domestic issues, e.g., state capacity, structural endowments, weight of path dependence…..

- Combinations of policies and internal structures produce specific outcomes: hence case-by-case policies, adaptability, flexibility of the Post-2015 framework

- This is demonstrated by the Report’s case studies: Nepal, Peru, Rwanda, Ivory Coast.
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