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## EXPORT DEPENDENCE AND EXPORT CONCENTRATION



*Economic openness explains the fact that an economy may be vulnerable to external economic shocks (as reflected by losses in export revenues and growth slowdowns), but the scale of impact depends largely on the degree of concentration of a country's export portfolio.*



Photo: Philippe Lissac/ILO



## Introduction

It is widely acknowledged that an economy's vulnerability to exogenous economic shocks is largely determined by its degree of exposure to the global economy — that is, by its degree of economic openness (Rodrik 2010, World Bank 2010, Briguglio 2009). Since economic openness is measured as the ratio of international trade to GDP, the transmission channels by which economic openness impact vulnerability can be import- or export-related.

Economies that are highly import-dependent — especially on strategic imports<sup>1</sup> — appear to be more vulnerable to the availability and cost of such imports. “There is a tendency for small states to be more vulnerable [because of strategic import-dependence] than other groups of countries” (Briguglio 2009).

For economies highly dependent on exports, the volatility in both export earnings and economic growth associated with economic shocks makes them extremely vulnerable. Given that exports constitute a significant and growing share of GDP for most developing economies — over 66 percent of developing countries have an export share exceeding 20 percent — an increased dependence on exports results in significant fluctuations in export earnings. Furthermore, export revenue volatility is strongly linked to growth volatility, so significant fluctuations in export earnings result in fluctuations in economic growth.

From an economic perspective, a country's exposure to external economic shocks generally depends on its reliance on exports because export earnings finance imports and also contribute directly to investment and growth. Production structures primarily oriented towards export-led growth expose countries to external shocks more than production structures reliant on domestic demand (Foxley 2009).

It is important to note, though, that, although the impact of an economic shock is typically registered through losses in export earnings, the size of impact (i.e., the magnitude of trade loss) depends on each country's mix of exports and main trading partners — that is, on its degree of export concentration. In other words, economic openness explains the fact that an economy may be vulnerable to external economic shocks (as reflected by losses in export revenues and growth slowdowns), but the scale of impact depends largely on

the degree of concentration of a country's export portfolio. By all accounts, higher degrees of export concentration are strongly correlated with greater volatility in export earnings and economic growth rates.

Export dependency and export concentration are rising sharply in regions such as Africa and the CIS and in the LDCs. Not surprisingly, these regions and countries have been most affected by the recent global economic crisis, as is evident through the data on export earnings and economic growth.

*Data on the share of exports in GDP indicates that, for developing countries, exports have been growing in relative importance to production for domestic consumption.*

Importantly, though, export dependency does not necessarily have to mean greater levels of export concentration. For instance, Asia, which remains the most export-dependent region in the developing world, is also the region with the most highly diversified exports. So, though the region was affected by the global crisis, evidence shows that it was less vulnerable to external shocks compared to other regions — in part because of highly diversified exports.

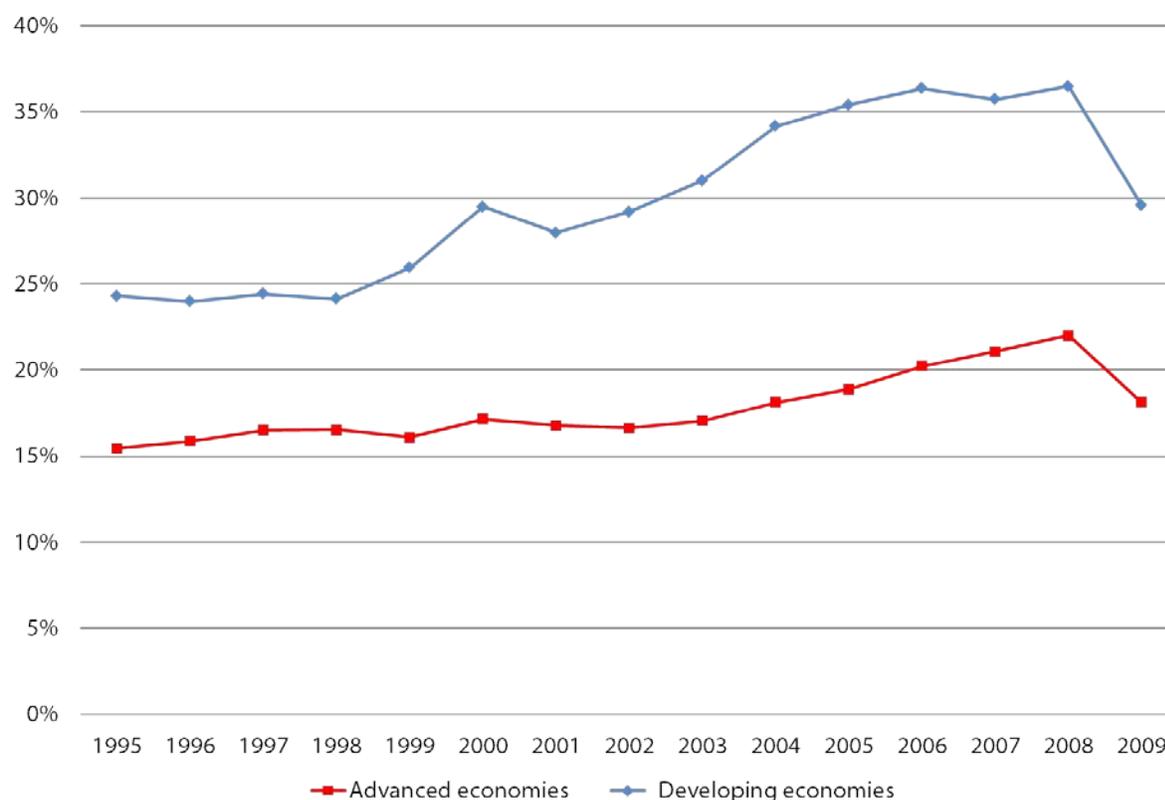


National policy measures focused on building resilience to economic shocks have pointed to the need to recalibrate an export-led growth strategy by strengthening domestic demand and by pursuing a trade agenda focused on export diversification. However, these national efforts need to be complemented by regional cooperation efforts that strengthen export diversification and by an international trade environment focused on trade facilitation and market access for the exports of developing countries –especially for the least developed among them.

## Trends in Export Dependency

Data on the share of exports in GDP indicates that, for developing countries, exports have been growing in relative importance to production for domestic consumption: exports as a share of GDP rose from 24 percent in 1995 to 37 percent in 2008 (Chart 1.1). As of 2008, the share of exports in GDP for developing countries was significantly higher than for the advanced countries, where exports represented only 22 percent of the value of their GDP. With the onset of the global recession in 2009 and the subsequent decline in both export volumes and prices, the export share in GDP fell in advanced and developing economies. In developing economies, the export share fell from 37 percent in 2008 to 30 percent in 2009 and in advanced economies from 22 percent to 18 percent. The share of exports in GDP grew faster in developing countries than in the advanced countries during this period.

**Chart 1.1: Export share in GDP, 1995–2009**



**Source:** Calculated using data from UNCTAD, *Handbook of Statistics 2009*



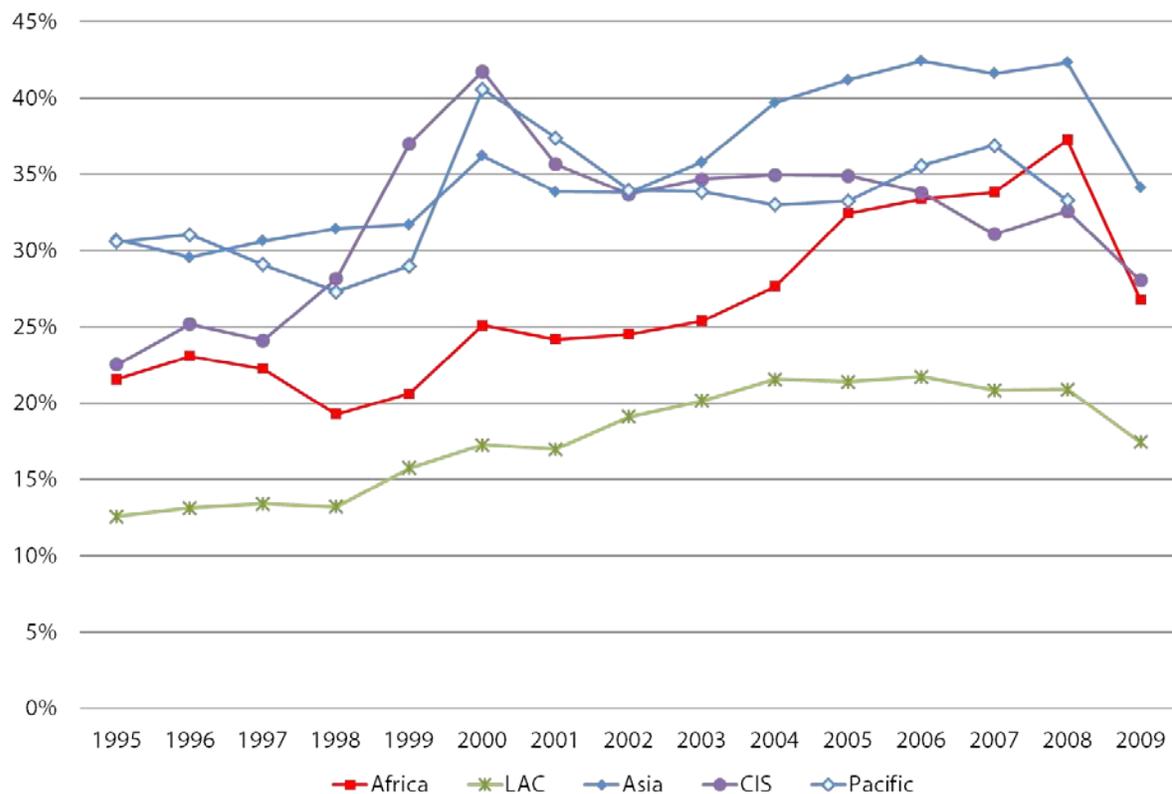
# Export Dependence and Export Concentration

Examining the export-to-GDP ratio by region (Chart 1.2) reveals that the ratio rose across all developing regions, with the fastest increase taking place in African countries, where it grew by 73 percent in just 13 years from 1995 to 2008. In Latin America and the Caribbean, the growth in the share of exports in GDP was next largest at 66 percent over the period. For the CIS countries, exports as a share of GDP grew rapidly in the late-1990s, peaking at 42 percent in 2000 and subsequently declining, reaching 33 percent in 2008. Exports as a share of GDP grew least in Asia, at 38 percent.

As of 2008, the Asia and Pacific region was the most export-dependent region of the developing world (with an export dependency ratio of 42 percent for Asia and 33 percent for the Pacific Islands) followed by Africa (37 percent) and the CIS (33 percent). Latin America and the Caribbean, as of 2008, had the lowest share of exports in GDP (21 percent) as compared to other developing regions.

In other words, the two regions with the lowest export-to-GDP ratios in 1995 had the fastest increase in export dependency (Africa and Latin America) and the region with the highest share of exports in GDP witnessed the slowest rate of increase in export dependency (Asia), suggesting a convergence between regions towards higher levels of export dependency. Moreover, the export-to-GDP ratio shows signs of procyclical behaviour<sup>2</sup> (exports rise more quickly than the growth rate during booms and fall more rapidly than growth during busts). This procyclicality is apparent upon examination of the decline in this ratio in 2009 consequent to the global

**Chart 1.2: Export share in GDP by region, 1995–2009<sup>3</sup>**



**Source:** Calculated using data from UNCTAD, *Handbook of Statistics 2009*



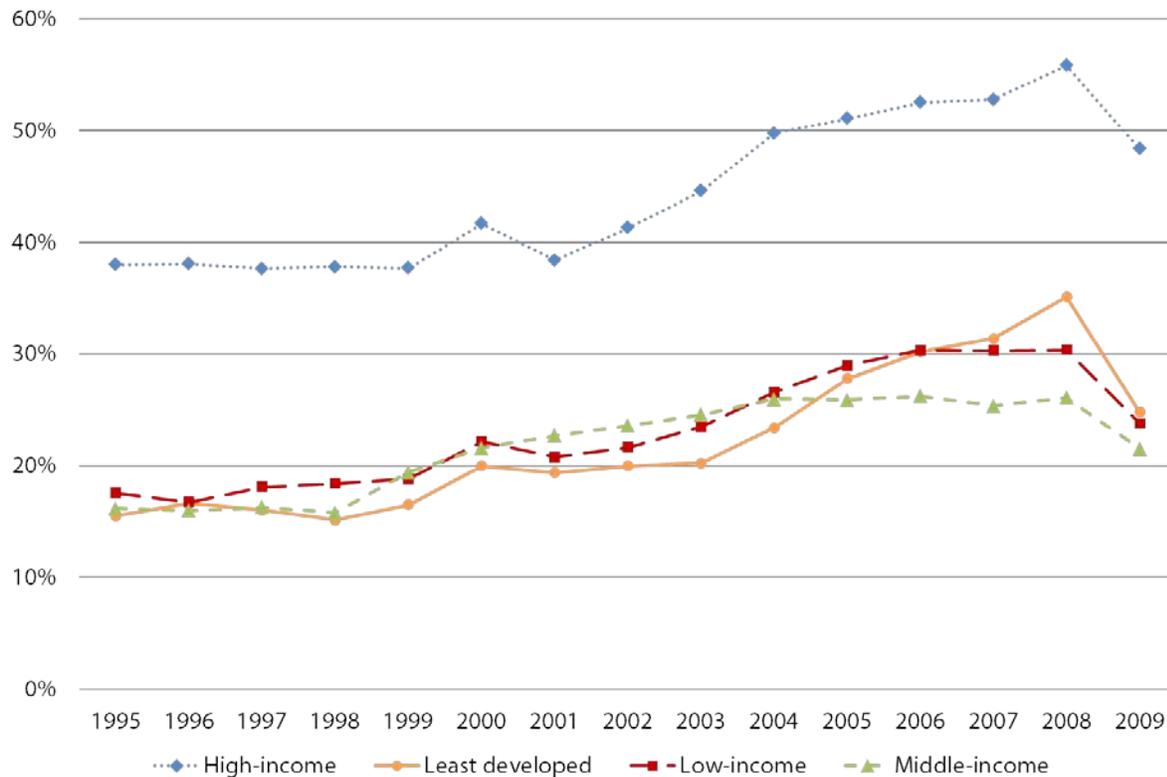
economic shock. The export share in GDP fell in all regions of the developing world. Africa had the biggest fall — from 37 percent in 2008 to 27 percent in 2009 — on account of falling oil prices and oil exports, whereas the CIS had the smallest decline in export dependency in 2009, from 33 percent in 2008 to 28 percent in 2009.

Examining the data on the share of exports in GDP by development status (Chart 1.3) indicates that, as a group, high-income developing countries are significantly more export dependent compared to countries in other income groupings. In 2008, high-income developing countries had an export dependency ratio of 58 percent compared to 30 percent in low-income and 28 percent in middle-income countries (MICs).

The rate of increase in export dependency between 1995 and 2008 reveals interesting trends: as a group, the fastest increase occurred in the LDCs (with a cumulative growth rate of 127 percent for the period) compared to LICs and the MICs (where the cumulative growth rates in the export-to-GDP ratio were 73 percent and 61 percent, respectively, for the period). The high-income developing countries experienced the lowest rate of increase in export dependency, with the export-to-GDP ratio growing by 47 percent.

The slump in trade volumes and revenues in 2009 reduced the degree of export dependency in all development groups. The fall in the export-to-GDP ratio was the largest in LDCs (from 35 percent in 2008 to 25 percent in 2009), followed by LICs (from 30 percent in 2008 to 24 percent in 2009). Next were the MICs, where

**Chart 1.3: Export share in GDP by development status, 1995–2009**



**Source:** Calculated using data from UNCTAD, *Handbook of Statistics 2009*



# Export Dependence and Export Concentration

the export share fell from 26 percent in 2008 to 22 percent in 2009. Interestingly, the development group with the highest degree of export dependency, the high-income development group, had the least fall in export dependency after the crisis in 2009. Export dependency in high-income developing economies fell from 56 percent in 2008 to 48 percent in 2009.

## Trends in Export Concentration

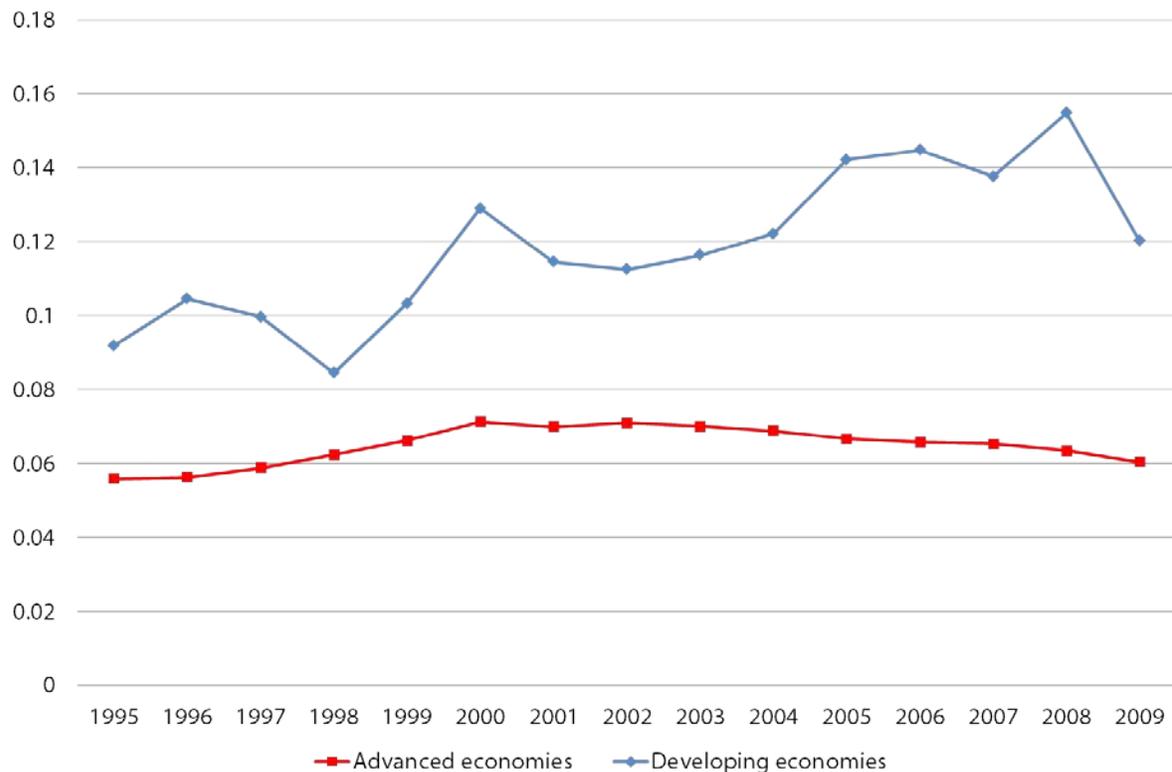
Export concentration<sup>4</sup> reflects the degree to which a country's exports are concentrated on a small number of products or a small number of trading partners. A country that exports one product to only one trading partner has a perfectly concentrated export portfolio. Conversely, a country whose exports are comprised

of a larger number of products and that trades with a larger number of trading partners has a lower export concentration ratio (ECR), i.e., has more diversified exports.

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The evidence on export concentration (Chart 1.4) indicates an increasing tendency towards export concentration across developing countries. In 2009, the top 25 countries with the highest concentration ratios were all developing

**Chart 1.4: Export concentration ratio, 1995–2009**



**Source:** Calculated using data from UNCTAD, Handbook of Statistics 2009



countries,<sup>5</sup> with 10 of them LDCs and 10 from sub-Saharan Africa. On the other hand, of the 25 countries with the lowest export concentration ratios, all but three (Brazil, China, Serbia) were advanced economies.

As of 2008, exports from developing countries were twice as concentrated compared to exports from the advanced economies: the ECR was 0.15 for developing countries, compared to an ECR of 0.06 for the advanced economies. The ECR for developing countries increased from 0.09 in 1995 to 0.15 in 2008—an increase of 68 percent, compared to the 14 percent increase in advanced economies. The ECR also appears to be more strongly procyclical in developing countries: it rose prior to the 1997 crisis and then picked up again after 1998, only to decrease thereafter in 2001. This procyclicality appears especially pronounced after the 2008 crisis: the ECR in developing economies fell by 22 percent between 2008 and 2009. On the other hand, the ECR in advanced economies shows no significant fall after 2008.

In other words, although advanced and developing countries witnessed similar increases in their share of exports in GDP, only the developing economies witnessed a pronounced increase in their export concentration ratios. Put differently, despite the growing participation of developing countries in world trade, their exports are increasingly more concentrated in a narrow range of products, compared to the more advanced economies. The tendency towards increased export concentration remains confined mostly to developing countries.

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Examining trends in export concentration by region (Chart 1.5) indicates that Africa had the highest export concentration ratio throughout the period 1995–2008 and also experienced the greatest increase in export concentration: the ECR nearly doubled from 0.27 in 1995 to 0.48 in 2008. For the CIS countries, export concentration grew by 69 percent over the period, making it the region with the second highest export concentration ratio. For Latin America and the Caribbean, the ECR rose by 61 percent, whereas the ECR for developing countries in Asia rose by 43 percent. The Pacific Islands did not see any significant change in their ECRs during this period.

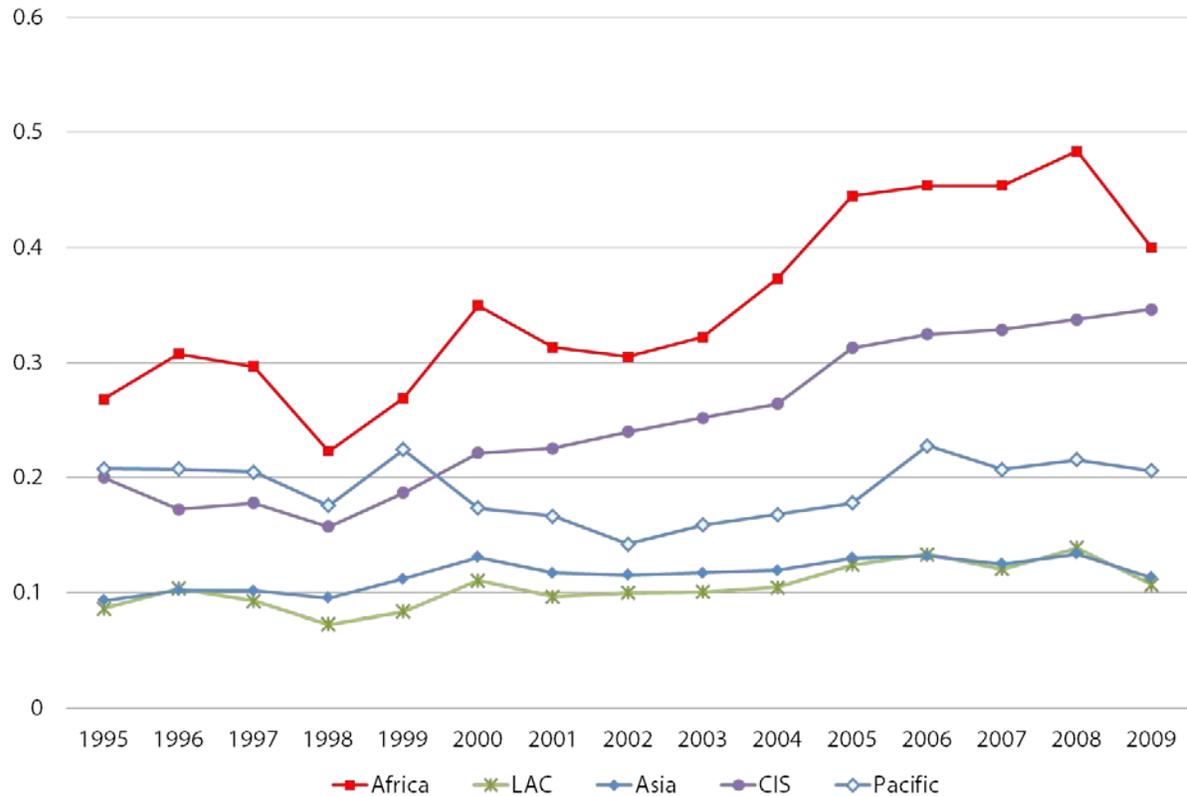
As of 2008, the region with the highest degree of export concentration was Africa (0.48), followed by the CIS countries (0.34) and the Pacific Island States (0.22). For countries in Latin America and the Caribbean, the ECR stood at 0.14 and the lowest degree of export concentration was in Asia (0.13). In 2009, as the economic crisis reduced world trade volume and prices, the ECR fell in all developing regions with the exception of the CIS, where the ECR increased marginally by 3 percent between 2008 and 2009. Latin America and the Caribbean witnessed the biggest decrease in their ECR, which fell by 23 percent, followed by Africa, where the ECR fell by 17 percent. Between 2008 and 2009, the ECR fell by 15 percent in Asia and by 4 percent in the Pacific.

This regional picture reveals extremely interesting trends: although Asia is the region with the highest export dependency, it has the lowest degree of export concentration. In other words, the portfolio of exports from Asia appears to be much more diversified relative to other regions.<sup>6</sup>

Examining the ECR for countries by development status (Chart 1.6) also reveals interesting trends: the LDCs had the largest increase in ECR. In just ten years (from 1998 to 2008), the ECR of the LDCs increased from 0.23 to 0.55. Clearly, the near tripling in the ECR of LDCs along with the doubling of export dependence for these countries renders them excessively vulnerable to external economic shocks.



### Chart 1.5: Export concentration ratio by region, 1995–2009



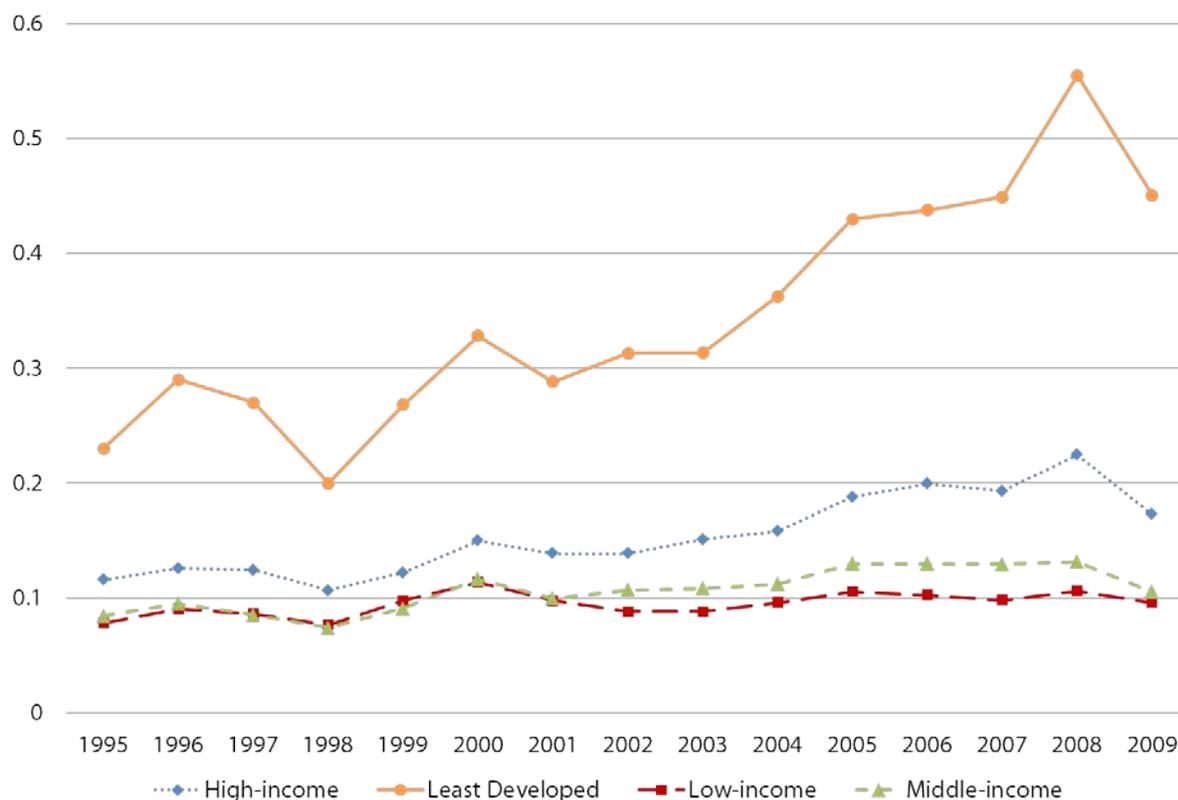
**Source:** Calculated using data from UNCTAD, *Handbook of Statistics 2009*

Although the ECR rose in the MICs, the increase was less than that in the high-income group. Export concentration over the period for MICs rose by 56 percent, compared to 94 percent for high-income countries. Curiously, low-income developing countries witnessed the least increase (36 percent) in their ECRs. This is largely on account of China, which has a very low ECR and a very high share of exports relative to other countries in the group.

As of 2008, LDCs had the highest export concentration ratio (0.55), followed by the high-income (0.22), middle-income (0.13) and low-income group of countries (0.11). The high ECR for the high-income group of countries is due to the fact that the latter includes the oil exporting countries from the Gulf States, which have extremely high concentration ratios. However, the oil exporters witnessed the biggest drop in their ECR as a result of the crisis in 2009. The ECR in high-income developing economies fell by 23 percent between 2008 and 2009. The ECR in the MICs fell by 20 percent followed closely by the LDCs where the ECR fell by 19 percent. In LICs, the ECR fell by 10 percent.



**Chart 1.6: Export concentration ratio by development status, 1995–2009**



**Source:** Calculated using data from UNCTAD, *Handbook of Statistics 2009*

## Economic Shocks, Export Earnings and Growth Volatility

As the 2007–2008 crisis hit developing countries, export earnings declined significantly across all regions. For the developing world as a whole, export revenues fell by 23 percent, but the biggest losses were registered in the CIS region, followed by the Middle East and Africa (Chart 1.7).

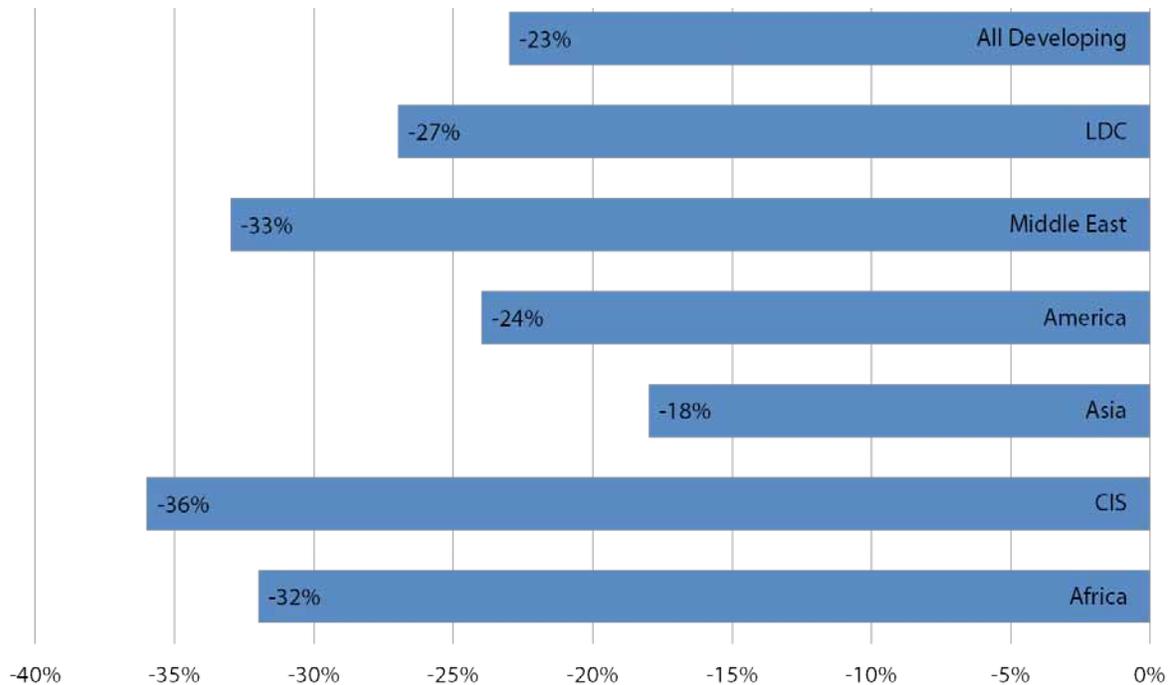
In Africa, export revenues declined sharply as a result of the fall in global demand and in international prices.<sup>7</sup> “Exports from the continent are expected to fall by more than USD 250 billion in 2009” and Africa “will suffer a shortfall in trade taxes to the tune of USD 15 billion, representing 1 percent of GDP and 4.6 percent of government revenue” (African Development Bank Group 2009).

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Given the high and growing dependency of so many developing countries on exports, growth rates plummeted as export incomes fell: for developing countries as a whole, as export revenues fell by 23 percent in 2009, the rate of growth dropped from 5.7 percent in 2008 to 1.6 percent in 2009 (Chart 1.8). The CIS region, which witnessed the steepest decline in export revenues, registered the biggest decline in GDP growth, whereas regions with below-average declines in export revenues (Asia) witnessed a below-average decline



**Chart 1.7: Decline in export revenues, 2009**



**Source:** World Trade Organization, *World Trade Report 2010*

in economic growth (growth rates for East Asia and the Pacific fell from 8.5 percent in 2008 to 7.1 percent in 2009); growth rates in South Asia actually rose in 2009.

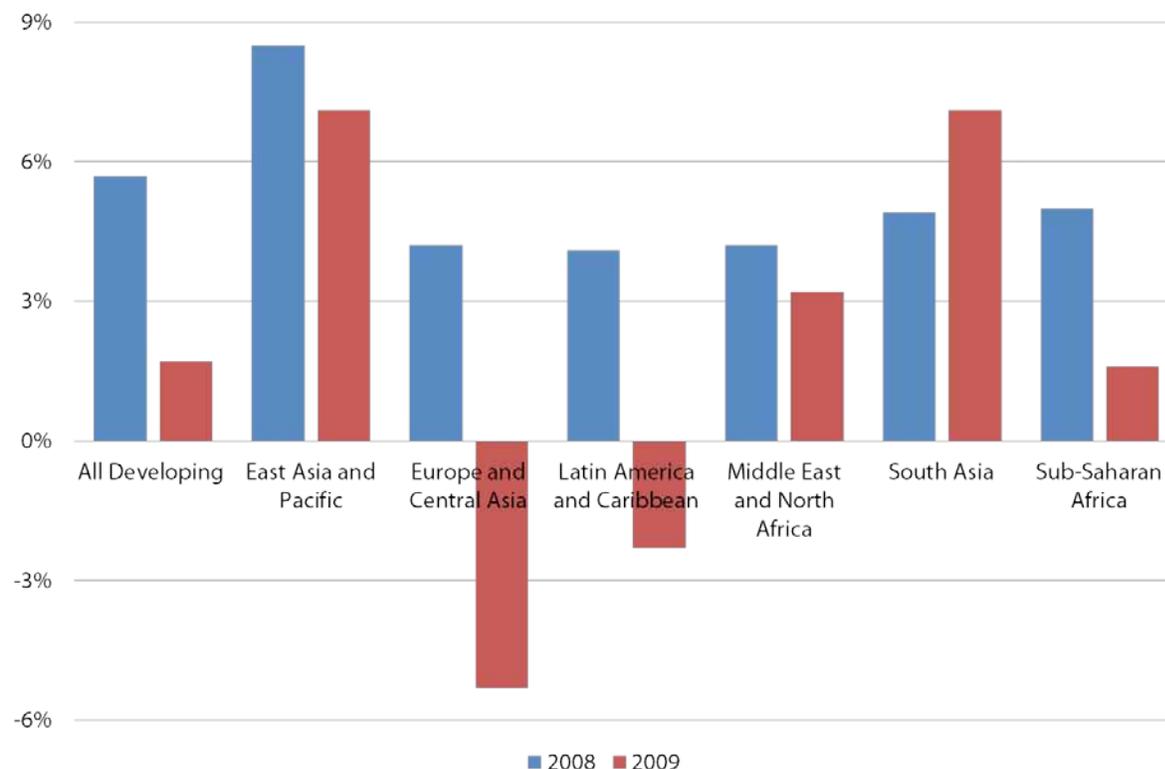
Although, as noted earlier, export dependence increases an economy's susceptibility to external shocks, the size of the loss in trade revenue depends on each country's mix of exports and main trading partners (i.e., on its degree of export concentration). This, then, explains the difference in the size of loss that different countries and regions experienced. It explains why Asia, despite being the most export-dependent region but one with the most diversified export portfolio, lost the least amount in export revenues compared to regions like Africa that, despite being relatively less exposed, had an export basket that was highly concentrated. "The reliance of most countries on a narrow range of commodities as well as a narrow range of markets, makes African export earnings extremely vulnerable to volatility in these markets" (TWN 2010).

More specifically, Asia, with a highly diversified export basket, lost 18 percent of its export revenues in 2009, while regions with higher export concentration ratios (CIS, the Middle East and Africa) lost more than 30 percent of their export earnings in the same year (36 percent, 33 percent and 32 percent, respectively).

Since the loss in export revenues directly impacts economic growth, a greater loss in export earnings causes a greater drop in economic growth. In Asia, for instance, growth rates for the East Asia region declined slightly by 1.4 percent between 2008 and 2009 and, in fact, growth increased in South Asia. On the other hand, regions that lost over 30 percent of their growth revenues in 2009 experienced plummeting economic growth rates. In the CIS region, for example, economic growth plummeted from a growth rate of 4.1 percent in 2008 to a



**Chart 1.8: Economic growth rates by region, 2008–2009**



**Source:** Calculated using data from World Bank, *Global Economic Prospects 2010*

contraction of 5.3 percent in 2009. Likewise, in sub-Saharan Africa, growth decreased from 5 percent in 2008 to 1.6 percent in 2009.

## Export Concentration, Export Earnings and Growth Volatility

If a country's exports are perfectly concentrated, then its export earnings will fluctuate with international price fluctuations. Such fluctuations, especially in the case of commodities, can be very large varying by 30–50 percent on a monthly basis. Countries with a more diversified portfolio will find that price fluctuations in the prices of two or more products will have a smoothening effect on total earnings. The more diversified and unrelated a country's exports, the less volatile its earnings will be. Put differently, a more diversified export portfolio will have a more stable stream of export revenues (Samen 2010).

Examining the relationship between export concentration and export revenue volatility for the period 2002–2008 (Table 1.1) shows that increased export concentration is strongly correlated with higher export earnings volatility: regions with a higher export concentration ratio have a higher relative deviation in export earnings. The LDCs that have the highest export concentration ratio as a group also have the highest relative deviation in export earnings.



**Table 1.1: Export Concentration and Export Revenue Volatility, 2002–2008**

Development Status	ECR 2002	ECR 2008	Change in ECR	Relative deviation of export earnings
Advanced economies	0.07	0.06	-11.6%	26.4%
Developing economies	0.11	0.14	26.7%	38.6%
Least developed countries	0.31	0.54	71.2%	52.6%

*Source:* Calculated using data from UNCTAD, *Handbook of Statistics 2009*

Validating these findings are the results of a quick regression using UNCTAD’s sample of 133 countries for the period 1996–2008, which shows that a 1 percent increase in the ECR results in a 0.5 percent increase in export revenue volatility.

In light of export revenue and growth rate volatility and their ensuing implications for poverty reduction, several studies have argued that export diversification is beneficial for long-run growth.

Export diversification<sup>8</sup> is defined as the change in the composition of a country’s existing export product mix or export destination (Ali, Alwang and Siegel 1991) or as the spread of production over many sectors (Berthelemy and Chauvin 2000).

It has been argued that, by providing a broader base of exports, diversification can lower instability in export earnings, expand export revenues, upgrade value added, and enhance growth through several channels. These include: improved technological capabilities via broad scientific and technical training as well as learning by doing; facilitation of forward and backward linkages within output of some activities that then become inputs of other activities; and increased sophistication of markets, scale economies and externalities. “When exports are more diversified, knowledge spillovers in the form of productivity improvements, efficient management and increased technical, technological and market knowledge tend to be enhanced” (Gutierrez de Pineres and Ferrantino 2000).<sup>9</sup>

Empirical studies testing the relationship between export diversification and growth find that export diversification boosts economic growth (Herzer and Nowak-Lehmann 2006, Al-Marhubi 2000, De Ferranti et al. 2001). For instance, a study using panel data for Latin American countries finds a positive relationship between export diversification and per capita income (Gutierrez de Pineres and Ferrantino 2000) and data from sub-Saharan African countries shows a positive relationship between export diversification and total factor productivity, with increased factor productivity benefiting economic growth (Ben Hammouda et al. 2010).

## Building Resilience: Policy Options

The vulnerability of countries reliant on export-dependent growth and having highly concentrated exports has been amply documented, especially in the aftermath of the recent economic crisis. When foreign demand falters, such countries find themselves with collapsing export prices and depressed growth. This is why a number of development policy makers are focusing on the role of domestic demand. “In order to protect themselves and the MDGs from exposure to external shocks, countries may want to generate domestic



demand in a sustainable way by increasing household incomes and consumption, alongside boosting corporate investment” (UNDP, ADB, UNESCAP 2010, Griffith-Jones and Ocampo 2009, Chhibber et al. 2009).

The growing reliance on exports has not stimulated a process of export and economic diversification. Instead, exports from the poorest regions and from the poorest countries have become even more concentrated. Given the risks associated with export concentration, policies to promote export diversification have also received considerable attention.

### *Boosting Domestic Demand*

In the wake of the recent crisis, many countries introduced measures to boost domestic demand as a way of stimulating their economies (Box 1.1). These, however, were mostly contingency measures — part of a stimulus package introduced by countries to compensate for the fall in foreign demand. Given the vulnerability of so many poor countries to external economic and financial shocks, policy makers may want to look at strengthening domestic demand as a way of lessening export dependence and building more resilient production systems over the longer term.

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## **Box 1.1: Increasing Domestic Demand Cushions Economic Downturn in Asia**

In the global downturn, and especially in 2009, all major economies in Asia experienced declining exports. However, the region’s large developing countries — China, India, Indonesia, Viet Nam and the Philippines — retained positive and (except for the Philippines) high economic growth rates as expanding domestic demand made up for export plunges.

In China, the major driver offsetting the negative impact of falling exports was gross capital formation, spurred by substantial stimulus measures. Private consumption also helped. In India, Indonesia, and Viet Nam, domestic investment and private consumption were equally important drivers of growth. In the Philippines, where investment was sluggish, growth was maintained mostly by a continuing rise in private consumption. India, Indonesia and the Philippines significantly increased government consumption. The latter contributed to growth in all five large economies.

In the contracting Asian economies, internal markets were generally small and thus domestic demand was insufficient to offset the export squeeze. Malaysia and Singapore

retained positive growth of private consumption and increased government consumption, but failed to avoid dramatic falls in domestic investment. Taiwan suffered from both sluggish private consumption and plummeting gross capital formation. In the Republic of Korea, growth of private consumption fell to a critically low level, but remained positive. Investment fell significantly, but the decline of exports was smaller than elsewhere.

Viet Nam was one of the fastest-growing economies in the East Asia and Pacific region both before and after the global economic crisis. After registering a real GDP growth of 5.3 percent in 2009, Viet Nam’s economy expanded an estimated 6.8 percent in 2010. Viet Nam, like China, stands out for achieving not only a higher average growth rate, but also a more stable growth path. The large stimulus package — which took the form of a low base (prime) rate, the injection of liquidity through lower reserve requirements, an interest rate subsidy, acceleration of public investment, reduction in corporate income tax, personal income tax and halving of the value added tax (VAT) in selected items — appears to have provided the necessary boost to private consumption and investment to maintain economic



## **Box 1.1: Increasing Domestic Demand Cushions Economic Downturn in Asia (contd.)**

growth. Real government consumption in Viet Nam also grew rapidly in 2009 (7.6 percent) and 2010 (6.9 percent).

The Government of Viet Nam was, however, slow at responding to the spiraling inflation, which hit 12.2 percent in early 2011. Inflation was driven by external factors, such as the hike in global commodities prices, and internal factors, including increased domestic demand and weather- and disease-related domestic supply shocks. To help tame inflation rate, the government publicly indicated its intention to pursue “tight and prudent monetary and fiscal policy” and approved a wide range of monetary, fiscal and structural policy reforms, intended to cool an overheated economy.

The Asian experience following the recent economic crisis illustrates the key role that domestic demand plays in bolstering economic growth in the face of contracting global demand. The high investment potential of the private sector and expansion of domestic consumption bodes well for future growth. However, in boosting domestic demand, the governments may need to be cautious about inflation as well as to continue support for their exports. In smaller economies with limited internal markets, exports remain a precondition for increased domestic demand and economic growth.

**Source:** Oxford Analytica, 2011, ‘Asia: Domestic Demand Will Lift Asia’, Oxford Analytica Research Daily Brief Service, 5 January, Oxford; World Bank, 2010, *Taking Stock: An Update on Vietnam’s Recent Economic Developments*, World Bank, Hanoi.

Measures to boost domestic demand could focus on:

- Investing in the capabilities and capacities of the poor. Consumption is likely to increase if a greater share of national income goes to the poor<sup>10</sup> and investing in the poor is also likely to increase their contribution to GDP, thus ensuring a more inclusive pattern of growth. Reducing poverty by broadening the economic base can unleash potential demand.
- Providing appropriate incentives to the private sector — through policies on exchange rates, taxation and subsidies — to make it more profitable for companies to invest in sectors that are oriented less towards exports and more towards meeting domestic demand and especially the needs of the poor.
- Adopting specific measures to strengthen small and medium-sized enterprises, which tend to depend heavily on local markets and on the mass market for consumer goods.
- Promoting regional development and employment creation programmes.

## **Box 1.2: Boosting Domestic Demand in China**

In 2009, China announced that it would make domestic demand its long-term growth strategy and take further measures to stimulate consumer spending, including in less developed and rural areas. In the decades prior to this, China’s impressive economic success was driven by an export-led growth strategy. However, the recent downturn in global demand revealed how vulnerable the economy

is to this type of growth strategy and the importance of domestic demand as a buffer against global market fluctuations.

Aggressive measures to bolster domestic demand announced by the Chinese government in 2009 were above all targeted at cultivating areas of high consumer



## Box 1.2: Boosting Domestic Demand in China (contd.)

demand and expanding consumption in new areas. For instance, China sought to improve the policy on automobile consumption, accelerate development of markets for second-hand cars and car rental, and guide and promote rational spending on automobiles. As a result, purchases of cars in 2010 were 92.4 percent higher than in 2008, at least in part reflecting government-financed discounts for traded-in and fuel-efficient cars.

The Chinese government also initiated programmes for bringing home appliances and agricultural machinery to the countryside. It devoted 40 billion yuan in 2009 to subsidizing the purchase of home appliances in rural areas and to trading in old home appliances. It encouraged retailers and commercial chains to open stores in more townships and villages and intensified the development of consumption facilities and service networks in both urban and rural areas, such as safeguarding the legitimate rights and interests of consumers, and developing consumer credit.

In order to increase rural incomes and consumption capacity, China announced that it would continue to improve the distribution of income, raise the proportion of the national income that goes to wages, increase the proportion of government spending dedicated to well-being, and increase subsidies to farmers and low-income urban residents. In 2009, China introduced a rural pension scheme and made it possible to transfer pension accounts across regions. By 2010, the government had invested in projects for developing low-income housing, education, medical infrastructure in rural areas, and other types of infrastructure improvements, including farmland development and water conservancy projects, railways, and freeways.

For example, to develop low-income housing, the government set a target to solve, within three years, the housing problems of 7.5 million low-income urban families

and 2.4 million families living in shantytowns in forests, on reclaimed land and around coalmines. In 2010, work was begun to build low-income housing and renovate run-down areas across the country with a total of 5.9 million units, surpassing the target by 100,000 units. This figure consists of 3.22 million units of low-income housing and 2.68 million units of housing in run-down areas; throughout 2010, work was basically completed on 3.7 million units.

To facilitate an increase in rural incomes, the Chinese government pledged to raise the floor prices for major grain varieties, expand the scale of agricultural subsidies, and raise standards. The latter envisages adjusting agricultural output subsidies with changing input prices on diesel fuel and fertilizers. The government announced strong support to specialized farmer cooperatives, various service organizations in rural areas, and leading industrialized agricultural production enterprises.

Finally, the master strategy for large-scale development of the less developed western region includes measures such as: issuing a list of industries in the western region encouraged by the state; giving greater support to the development of infrastructure and ecological and environmental conservation; promoting the development of industries that can take advantage of local strengths; accelerating the development of key national experimental zones for development and opening up; and launching demonstration projects for ecologically oriented development together with the project to tackle problems in the development of contiguous areas that have high concentrations of poverty and face special difficulties. To energize the development of the central region, the government plans to bring in the industrial production from booming coastal regions and boost city clusters, which are further expected to drive the development of their surrounding areas.

**Source:** Chinese Government, 2009, *Report on the work of the Government delivered at the Second Session of the Eleventh National People's Congress* by Wen Jiabao, March 5, [www.gov.cn/english/official/200903/14/content\\_1259415.htm](http://www.gov.cn/english/official/200903/14/content_1259415.htm); Chinese Government National Development and Reform Commission, *Report on the implementation of the 2010 Plan for National Economic and Social Development and on the 2011 Draft Plan for National Economic and Social Development*, Fourth session of the Eleventh National People's Congress, March 5, ([online.wsj.com/public/resources/documents/2011NDRReportEng.pdf](http://online.wsj.com/public/resources/documents/2011NDRReportEng.pdf))



# Export Dependence and Export Concentration

Studies have pointed out that the potential for boosting domestic demand is evident from the considerable savings in several countries. For instance, in the case of Asia, it has been pointed out that, since 2001, the savings rate in the Asia Pacific region has either remained stable or increased (UNDP, ADB and UNESCAP 2010).

## *Promoting Export Diversification*

Dependence on a narrow range of exports gives rise to risks associated with the lack of diversification, thereby exacerbating a country's vulnerability to economic shocks. Export diversification aims at mitigating these risks, including the volatility and instability in export earnings — which in turn have adverse macro-economic effects on growth, employment, investment planning, export capacity, foreign exchange reserves, inflation, capital flight and, *inter alia*, debt repayment (Samen 2010).

Generally, export diversification takes the following forms: (a) horizontal diversification takes place within the same sector (primary, secondary or tertiary) and entails an adjustment in the country's export mix by adding new products to existing export baskets within the same sector (e.g., production of off-season crops);

(b) vertical diversification entails a shift from the primary to the secondary or tertiary sector (e.g., moving from basic commodity extraction to commodity processing), which typically entails increasing value added in activities such as processing, marketing or other services; and (c) diagonal diversification entails a shift from imported inputs into the secondary and tertiary sector (e.g., using imported goods to produce manufactured products for exports) (Samen 2010).

*Typically, the policy reforms necessary to foster export diversification require a multi-faceted approach spanning trade, investment and industrial policies, and institutional reforms.*

Another objective of export diversification is to reduce the dependence upon one or a limited number of geographical destinations for exports. For instance, 29 of the 84 MICs ship more than 50 percent of their exports to a single market. By 2008, 50 percent of all developing country exports went to just seven destinations (United States, China, Japan, Hong Kong, Germany, the Republic of Korea and the Netherlands). Compared to other developing regions, exports from Latin America and the Caribbean appear to be the most geographically concentrated; the United States alone accounted for 43 percent of the region's exports in 2008 (UNCOMTRADE 2009).

Policies to promote export diversification will clearly depend in the first instance on a comprehensive analysis of the country's specific position in the international division of labour, its position in the global supply chain and the prospects of world demand. Typically, the policy reforms necessary to foster export diversification require a multi-faceted approach spanning trade, investment and industrial policies, and institutional reforms.

Specific measures to promote export diversification should include:

- (A) Targeted industrial and investment policy to develop potentially new areas of comparative advantage** and establish the conditions needed for local firms to access export markets. Increasing market access usually involves a reduction of trade barriers for exporting firms; the setting up of marketing and distribution firms that provide local producers with the necessary know-how to gain access to world markets; an institutional and regulatory framework that supports export diversification; improved communications technology; and infrastructure investments, which increase productivity and enable local firms to compete in global markets.



- **Financing export diversification:** An export diversification strategy should make available financing facilities for export-oriented industries on a priority basis since inadequate trade finance is a major constraint for potential exporters, especially small and medium firms that have no access at all to finance or only at prohibitively high interest rates. For instance, private commercial banks may be persuaded to give loans to exporters at rates of interest fixed by the government. A more developed financial sector will allow more financing opportunities for new and innovative entrepreneurs who might have the potential to develop new export products. It will also allow for the opening of credit lines for export and export-credit insurance. In Malaysia, for example, official schemes are available for the refinancing, insuring and guaranteeing of export credits (UNESCAP 2004). The Malaysia Export Credit Insurance Berhad (MECIB), with an underwriting capacity of up to 125 million Malay dollars, provides commercial banks with coverage of losses against loans to exporters and suppliers. Facilities offered by MECIB include a comprehensive short-term policy, a confirming-bank policy, a banker's export finance insurance policy, a bond indemnity support facility and a buyer credit guarantee facility.
- **Infrastructure development:** Efficient infrastructure is a precondition for good export performance. Infrastructure constraints, like lack of access to adequate power and gas supplies, can limit the ability of new firms to export. Transport infrastructure and port facilities that ensure that goods arrive on time, in good condition and with the least delivery time are a crucial element in any successful export diversification policy. The inadequate functioning of infrastructure may harm enterprises in many ways: by hampering production activities, delaying the movement of goods and passengers, and leading to a delay in the delivery of goods. It adds to business uncertainty and risk and imposes additional costs.

### **Box 1.3: Regional Infrastructure Development in Africa**

In response to the need to develop regional and trans-African infrastructures, the New Partnership for Africa's Development (NEPAD) has drawn up an infrastructure development plan and has been helping to establish institutions to mobilize financial resources for infrastructure development. Through cooperation, the continent has developed a significant part of the Trans-African Highways Network linking Africa's capitals and major economic production areas, having fixed 75 percent of the highway's missing links.

The option of establishing trade corridors is also being pursued. For example, the North-South Corridor Pilot Aid for Trade Programme is promoted by COMESA-EAC-SADC as a joint initiative. Its objective is to reduce the time, and so the costs, of road and rail travel along two main

corridors: (i) the Dar es Salaam Corridor, which links the port of Dar es Salaam to the Copperbelt; and (ii) the North-South Corridor, which links the Copperbelt to the southern ports of South Africa. In East Africa, the Northern Transport Corridor linking economies of Kenya, Uganda, Rwanda, the Democratic Republic of the Congo and Burundi has been in operation for several years. Discussions are currently underway to transform it from a purely transport corridor to the Northern Corridor Economic Zone that would cover parts of Kenya, Burundi, the Democratic Republic of the Congo, Rwanda, Uganda and the Sudan. Accelerating the implementation of these initiatives and consolidating their achievements would make an important contribution to intra-African trade and trade performance and economic growth more broadly.

**Source:** UNDP, 2011, *Regional Integration and Human Development: A Pathway for Africa*, UNDP, New York.



# Export Dependence and Export Concentration

- **Communication and technological infrastructure:** The development of an adequate and accessible communication infrastructure enhances firm productivity and allows more efficient and speedy communication with the rest of the world. Access to the internet and telecommunications is usually essential for the success of new export firms.
  - **Institutional and regulatory framework:** The regulatory and institutional environment prevailing in an economy can either promote or hinder export diversification (Parketa and Tamberi 2008). Complicated or cumbersome government rules and regulations relating to exports can undermine efforts to diversify exports. For instance, an analysis of trade support services in Africa highlighted how a deficient governance structure in national trade policy had hampered export development. Simplified and harmonized export regulations are thus necessary to promote export diversification (Bonaglia and Fukasaku 2003).
  - **Bonded warehouses:** Special bonded warehouses enable exporters to import and store inputs duty-free with minimal customs formalities. These warehouses are monitored using import and export passbooks and a re-tabulated input-output system, through which raw materials may be imported via an entry in a passbook without paying any customs duty or sales tax. The same value of raw materials is deducted from the passbook upon export of the finished product. Bonded warehouses were established successfully in Bangladesh for garment exporters, but then were extended to all exporters (UNESCAP 2004).
- (B) **Devising selective measures** to stimulate export diversification such as fiscal and direct credit incentives, selective subsidies and local content requirements. Such interventions can help firms improve their export competitiveness and can encourage a more balanced export mix. Many developing economies have used selective measures to stimulate export growth and diversification.
- **Export subsidies:** Countries that do have some sort of export subsidy programme could prioritize subsidies to potential new export sectors. The subsidies can come directly or as a tax incentive or exemption for qualified exporters. These measures reduce the cost of production and allow firms to survive at very low profit margins. For example, Bangladesh Bank provides limited subsidies to garment exporters if their products are locally manufactured using either 100 percent local raw materials or duty-paid imported raw materials (UNESCAP 2004). Bangladesh also exempts exporters from 50 percent of the corporate tax (UNESCAP 2004). In Malaysia, a double tax deduction is allowed for expenses that resident companies exporting manufactured and agricultural products incur. Some of the deductible items are expenditures for overseas advertising, the supply of free samples abroad, market research, the preparation of tenders for the supply of goods overseas, the supply of technical information abroad, public relations work connected with exports, exhibits and participation in trade or industrial exhibitions, the cost of overseas travel and accommodation, and the maintenance of an overseas sales office (UNESCAP 2004). Although these policies might promote export in all sectors, it has a bigger impact on new potential sectors that might be exporting at very slim profit margins. If the tax and subsidy export promotion programmes involve an element of prioritization for new potential export sectors, then they will better promote diversity of exports. However, it is important to note that the design of trade development measures should be carefully crafted and based on rigorous cost-benefit analysis and monitoring. Failure to do so can result in costly exercises with limited impact on the local economy. Subsidies that are likely



to favour rent-seeking behaviours should be limited, while subsidies that provide guarantees on export insurance or for working capital are to be preferred. Under the WTO, the use of export subsidies is regulated under the Agreement on Subsidies and Countervailing Measures.<sup>11</sup>

- **Local content requirements:** Developing countries can impose local content requirements on incoming FDI to ensure that the country realizes the employment and technology transfer benefits of FDI. Local content requirement policy stipulates that multinational firms must use a certain proportion of locally made parts and components. Such a policy can be used to promote export diversification by emphasizing the local procurement of parts and components from nontraditional export sectors. Local content requirement policies need to include specifications on exactly what 'kind' of local content is required. Investors will therefore be required to invest in physical, human and informational capital in the sectors that are targeted for export promotion.<sup>12</sup> Local content requirements were successfully used to diversify exports by a number of Southeast Asian economies in the 1980s and 1990s (for Malaysia, see UNESCAP 2004; for the Republic of Korea, see Chang 2000).

**(C) Investing in Human Capital Development.** Since much research has shown that a diversified export portfolio (and high-value manufacturing) is correlated with a more educated work-force (Carrere, Strauss-Kahn and Cadot 2007) the lack of skilled manpower is a key constraint on the ability of an economy to diversify its export basket (Gullstrand 2000, Parketa and Tamberi 2008). Countries aiming to diversify exports need policies on technology assessment, technology acquisition, adoption, adaptation and development and technology diffusion to raise worker (and firm) productivity in potential export sectors. High worker productivity translates into efficient production and can give the necessary cost edge to succeed in the global market. Private and public sectors can fund skill development training programmes.

**(D) Integration into Global Value Chains.** Technological advances and organizational changes in the global economy and within transnational corporations (TNCs) have fundamentally altered the way goods and services are produced. Global value chains with a high degree of specialization of individual players have become the norm for the production of goods and ever more for services as well. TNCs are increasingly outsourcing parts of their value chains in order to increase efficiency and competitiveness and to avail themselves of the lowest worldwide price options. In many instances, this has entailed the contracting of manufacturing or services to an efficient, low-cost producer in a developing country. As a result, transactions among the various parts of a single corporate system (intra-firm trade) are estimated to account for one third of global trade. Participation in global value chains, however, requires an ability to produce specialized goods or services at a demanding level of quality and quantity and within tight timelines. These demands have made it difficult for most developing countries to integrate into global value chains and to participate at the downstream level as providers of raw materials. In this regard, adequate and timely support from public and donor institutions is vital in order to secure access to open niches. Direct support may take the form of skills development, financial incentives for small and medium sized enterprises (SMEs) to invest in appropriate technologies, the creation of appropriate and effective regulatory frameworks for standards and quality assurance, assistance for establishing sustainable linkages between TNCs and local SMEs, improvement of local investment climate, encouragement and support for local economic development activities including cluster creation, and the strengthening of intellectual property rights protection (UNCTAD 2010).



## Box 1.4: Promoting Business Linkages in LDCs: UNCTAD's Business Linkages Programme

UNCTAD's Business Linkages Programme connects large companies with domestic suppliers in developing countries. It has proven to be a very useful tool for enhancing enterprise development in the LDCs. Recognizing the need to attract responsible FDI, Business Linkages Programmes in LDCs are based on a targeted approach. This approach focuses on attracting FDI that would best contribute to the development of productive capacities and the creation of an environment that fosters the establishment of business linkages between FDI and domestic firms, especially small and medium-sized enterprises (SMEs).

The majority of SMEs in developing countries do not have the capacity needed to benefit effectively from the rise of FDI and the outsourcing of production activities by transnational corporations (TNCs). A major focus of the programme is on empowering project partners to undertake business linkages above and beyond the life cycle of individual projects. Key stakeholders include TNCs,

investment promotion agencies, business associations, local banks and business services providers, relevant government departments, and SMEs.

One of the projects entitled "Building Productive Capacities in Developing Countries to Enhance their Participation in Global Supply Chains" was undertaken in four LDCs between 2008 and 2010: Mozambique, Uganda, the United Republic of Tanzania, and Zambia. Linkages were established not only in the agribusiness sector, but also in mining, tourism and services between 13 TNCs and 137 SMEs. Local business capacity was upgraded and refined through the provision of business development services, which added value to these SMEs, and contributed to improve relations with anchor companies. Sales value between participating TNCs and SMEs went up 15 percent on average and, in some cases, it went up to 50 percent. As a result, more than 1,600 jobs were created and the amount of loans obtained by the SMEs reached \$1.75 million.

**Source:** UNCTAD, 2011, *Foreign Direct Investment in Least Developed Countries: Lessons Learned from the Decade 2001–2010 and the Way Forward*, UNCTAD, Geneva.

- (E) **Designing incentive systems** that, for instance, encourage FDI flows into non-traditional sectors such as manufacturing or the production of new primary commodities or that encourage quality upgrades of existing exports. In this context, ODA can also be used to promote export diversification by supporting capability and infrastructure development in the export sectors of developing countries. Donors can support country efforts to develop a more efficient trade and investment support network by sharing their expertise in these areas and by providing access to trade data and regulations. "Experiences from the trade and investment support network in both OECD and non-OECD countries (such as Mauritius) can be extremely valuable to countries in need of reforming public agencies in charge of trade and investment promotion" (Bonaglia and Fukasaku 2003).
- (F) **Trade facilitation** is essential for export promotion and decreasing the cost of imports. Trade facilitation, as defined by WTO, is the simplification and harmonization of international trade procedures, where trade procedures are the activities, practices and formalities involved in collecting, presenting, communicating and processing data required for the movement of goods in international trade. Excess trade procedures create additional transaction costs incurred by participants in trade. The OECD calculates that each 1 percent of savings in trade-related transaction costs yields a worldwide benefit of \$43 billion (OECD 2003). Keeping that in mind, trade facilitation is increasingly becoming a focus of WTO trade round negotiations, aid for trade programmes, regional integration arrangements and national agendas. It is also important in streamlining global supply chains.



Trade facilitation may cover measures regarding: (a) formalities, procedures and documents and the use of standard and electronic messages for trade transactions; (b) the physical movement of goods through improvements in services (transparent, predictable, uniform), the legal framework, and the transport and communications infrastructure, as well as the use of modern information technology tools by services providers and users; and (c) the timely discussion and dissemination of trade-related information to all concerned parties (government, services providers and the trading community), ideally through an established consultation mechanism, such as a trade facilitation body (UNCTAD 2006).

Although there is a common understanding of the benefits of trade facilitation, its implementation is wrought with obstacles. Considering the trade environment's complexity, many different, often conflicting, interests are at work: trade operators and service providers on the one hand and customs and various ministries and regulatory agencies on the other hand. Institutional limitations add further to implementation difficulties. Policy executives tasked with identifying transaction cost problems, evaluating scope for trade facilitation and implementing trade facilitation programmes require a wide range of experience and skills (Granger 2008).

Thus, concerted efforts by national authorities with assistance from donor organizations are needed to stimulate trade facilitation process. Special efforts could be directed at aligning the interests of various stakeholders involved in the international trade, identifying the baseline and mapping out the scope of trade facilitation measures, capacity building, and fostering public-private partnerships.

## *Strengthening Regional Trade Cooperation*

Export diversification is not only about product diversification, but also about expanding the number of markets that a country exports to. Countries can consider diversifying their export markets to reduce dependence on a few sources of demand or they can boost intra-regional trade by improving transport links and simplifying customs and inspection procedures. Several sub-regions have very little trade between constituent countries, a gap that represents a major opportunity for realizing trade gains and strengthening regional resilience.

Regional cooperation can also be important for small and land-locked countries, since size can be a major constraint on their ability to diversify exports (Briguglio 2009). Such countries can enter into industrial collaboration and production sharing and follow joint trade and industrial policies. As noted by African countries, "the development of regional markets is necessary for African countries to exploit economies of scale, enhance export competitiveness and integrate effectively into the global economy (it is estimated that intra-Africa trade accounts for only 9 percent of Africa's trade" (TWN 2010).

- **Transit Treaties:** For the least developed landlocked countries (LLDCs), the extent of international trade largely depends on their relationship with neighbouring countries. Transit treaties allow landlocked countries to access the ports of neighbouring nations with relative ease and at minimal cost. Transit treaties involve an expedited and simplified treatment of cargo to and from the landlocked country, storage facilities dedicated to the landlocked country's cargo and access to major highways and roads. The transit treaty signed between India and Nepal in December 1996, for example, simplifies procedures to expedite cargo arriving in Indian ports that is destined for Nepal and provides storage facilities for Nepalese cargo (UNESCAP 2004).



## **Box 1.5: Developing a Single Window to Facilitate Trade in Senegal**

Senegal's electronic Single Window (SW) customs clearance system, ORBUS, is regarded as a success story in trade facilitation efforts for introducing electronic techniques to the trade implementation process. ORBUS was launched in 2004 following nearly 20 years of governmental efforts, including by the Ministries of Finance, Commerce, and Customs, to replace onerous paper-based trade processes with computerized exchanges among stakeholders. Its main objectives were to: (a) bring stakeholders of foreign trade into closer contact; (b) improve work processes; (c) simplify and harmonize procedures; (d) reduce trade-related costs and time; and (e) introduce new technologies in the government administration and within the business community.

Prior to the introduction of ORBUS, trade-related regulatory requirements and customs clearance procedures were time-consuming and often not transparent. Traders needed to file separate requests with each public and private agency involved in the clearance process. Typically, it would take more than four days for them to collect the required documents, which then had to be attached to their import declarations for inspection by the customs administration. A meat importer, for example, was required to file an import declaration form with the inspection body along with the invoice and then go to a bank to obtain the payment terms.

At the bank, the importer provided an exchange permit to pay import fees to the consignor. He obtained an insurance policy and then visited the livestock department with his certificate of origin to obtain a phytosanitary certificate and a food product importation permit from the department responsible for quality control.

The SW system replaced the numerous trade-related documents and physical steps previously required in the pre-clearance chain with a single form submitted electronically by the clearing agent through its web-based interface. The system automatically dispatches the single form to the various public and private bodies — banks, insurance companies, and the inspection service — involved in the transaction. Upon submission of a request in the SW, the system proposes a set of electronic documents required for the transaction and the request is automatically forwarded to the relevant stakeholders. Similarly, a separate web-based interface dedicated to customs officers and other agencies connected to the system enables them to receive and process trade requests. Through embedded functions, the interface enables processing officers to validate or reject requests or to ask for modifications. The system has reduced the trade documentation process down to half a day, whereas the previous paper-based system required four days.

**Source:** Diagne, I, 2011, 'Senegal's Transition from a Paper-based System to Paperless Trading System', UNNExT Briefing paper No. 05.

### *Enabling International Trade Environment*

Given the high degree of export dependency of so many developing countries, it is critical that they be able to access global markets for their products. But, nearly nine years since its launch, the Doha Round of multilateral trade negotiations is at an impasse. Since the last serious push for a breakthrough collapsed in July 2008, no new concrete deadline for the conclusion of the Round has been set, despite recent efforts to revive negotiations and the target announced by the Group of Twenty (G20) to complete the Round in 2010. There has been no significant reduction in the tariffs imposed by developed countries in 2008, and average tariffs on key products from developing countries remain relatively high (UN 2010).

Meanwhile, the removal of tariffs and other trade barriers faced by exports from developing economies (i.e., any measure taken to reduce the cost of entry into the markets of advanced countries) has the potential to increase product diversity. Research has shown that a 10 percent reduction in market entry costs is associated with a 3–4 percent increase in export product diversity and a 5 percent increase in market diversity (i.e., the number of geographical markets served) (Dennis and Shepherd 2007). Import tariffs shape the export basket



of developing countries. A reduction in import tariffs will help developing economies integrate in the world economy and the global supply chain (Dornbusch et al. 1977, Venables 2003, Ruhl 2005, Yi 2003).

The special needs of LDCs, which tend to be highly vulnerable to trade shocks and possess weak exporting capacity, have been left unaddressed. A gap remains in reaching the target to provide duty-free and quota-free (DfQf) market access to at least 97 percent of products originating in LDCs, a target that still falls short of providing full coverage. There are significant regional and country variations and gaps in duty-free access. While many developed countries provide 100 percent DfQf access for LDC exports, there is room for improvement in many of their programmes, especially because the estimated costs of extending full market access to LDCs on production and exports in preference-giving countries are very small. Large developing countries have also made significant contributions by granting DfQf access to LDCs. In view of the increasing role of emerging developing countries as drivers of world trade, this is a positive development that holds potential for expanding LDC exports (UN 2010).

To enable developing countries to repeat greater gains from trade, the international community should:

- Intensify efforts to conclude a development-oriented Doha Round of trade negotiations within a realistic time-frame in order to effectively establish a more open, equitable, rule-based, predictable and non-discriminatory multilateral trading system.
- Ensure that donors accelerate delivery on existing aid commitments, including through renewed technical, financial and political support to the Aid for Trade initiative,<sup>13</sup> as well as through increased support to the Enhanced Integrated Framework, which is the entry point for LDCs in accessing Aid for Trade.
- Accelerate delivery on the commitment made by developed countries in 2005 to eliminate, by 2013, all agricultural export subsidies, and other support measures with equivalent effect, in order to increase the ability of developing countries to produce and export agricultural products competitively.
- Accelerate progress towards the full implementation of the DfQf market access for all products exported by LDCs, which remains a critical aspect for accelerating employment creation in LDC export sectors, and combine this with the creation of more transparent and simplified rules of origin.
- Sign preferential trade agreements (PTAs) that give priority access to developing countries, usually LDCs, to help diversify their exports.<sup>14</sup> For example, Collier and Venables (2007) show that various sub-Saharan African countries have had a large manufacturing export supply response to trade preferences following the African Growth and Opportunities Act, which gives trade preferences to African countries in the United States market. Another example of a successful PTA is the Caribbean Basic Economic Recovery Act (CBERA), which gives preferential treatment to exports from the Caribbean basin countries to the United States. De la Cruz calculates that the CBERA successfully increased the export diversification of Caribbean exports to the United States. Mineral exports from the region used to account for 57 percent of exports in 1983. By 1999, minerals were only 8 percent of Caribbean Basin exports to the United States (De la Cruz 2008). The North American Free Trade Agreement (NAFTA) has actually improved Mexico's product diversification, though at the cost of geographic concentration (Lewis 2004).



## **Box 1.6: Export Diversification Strategy: The Case of Cambodia**

Between 1998 and 2007, Cambodia demonstrated remarkable average annual economic growth of about 10 percent. The expansion was driven largely by rapid export growth, which increased dramatically from 16 percent of GDP in 1993 to 60 percent of GDP in 2009 (World Bank 2011). Cambodia's textile and garment industry has been the cornerstone of this export performance, accounting for 16 percent of GDP in 2007 and 14 percent of GDP in 2009 and representing the largest source of job growth. This expansion in the garment sector has been also complemented by growth in the tourism sector.

Reliance on exports from textile and garment industry is evident in Cambodia's high export concentration ratio (ECR), which equaled 0.415 in 2009.<sup>i</sup> The vulnerability associated with such a high ECR is compounded by a relatively limited export market: Cambodia's traditional export market is comprised of the United States, the European Union, Singapore, Thailand, and Malaysia. The sensitivity of Cambodia's economy to external shocks was revealed during the recent global economic slowdown, which resulted in the contraction of garment exports by almost 20 percent of their value in 2008 and the loss of more than 45,000 jobs in the garment sector by 2010, according to Cambodia's Ministry of Labour. Moreover, economic growth in Cambodia slowed to 6.7 percent in 2008 and the economy contracted by 1.9 percent in 2009.

Rural poverty and inequality pose additional constraints on sustaining the benefits of economic growth in Cambodia. Although there was a substantial reduction in poverty during the last two decades (poverty headcount declined from 47 percent in 1994 to 30 percent in 2007), living standards have increased more rapidly for the wealthier groups and the rural-urban divide remains striking. Furthermore, despite the rapid growth of the garment industry, 59 percent of households depend on agriculture as their primary source of income (ODI 2010).

To help reduce vulnerability to economic shocks and promote the generation of jobs, especially for the poor, the Cambodian government decided to integrate a trade policy into a broader national development and poverty reduction agenda. Cambodia was one of the

first countries to pilot the Integrated Framework (IF) for Trade-Related Technical Assistance to LDCs.<sup>ii</sup> In 2001, a Diagnostic Trade Integration Study (DTIS) was conducted for Cambodia; this was later revised and paved the way for the adoption of Cambodia's Trade Integration Strategy in 2007. A key instrument in implementing the Strategy was a 'sector-wide approach' (SWAp) in the trade sector, adopted by the Government of Cambodia in consultation with development partners.

The 2007 Trade Integration Strategy aimed at: (i) identifying a set of possible priority product or service sectors to serve as a basis for strengthening and diversifying Cambodia's export basket; (ii) identifying bottlenecks, either common to all priority sectors or specific to each, that need to be removed to promote development of those export sectors; (iii) linking trade sector development more clearly with human development and poverty reduction; and (iv) serving as a basis for formulating clear trade sector development priorities shared by the Cambodian government, its development partners, and other concerned stakeholders to be implemented by all through a Trade SWAp.

Nineteen products and services were identified to have export potential, including garments, footwear, rice, cassava, rubber, fish, cashew nuts, silk, soybeans, corn, wood products, light manufacturing, and tourism; sector-specific or cross-sector constraints to the development of these products were also identified. Cross-sector interventions to increase competitiveness of the products focus on trade facilitation, investment facilitation, removing technical barriers to trade, sanitary and phytosanitary measures, and intellectual property rights. The strategy also pinpoints new promising markets in Asia, the Middle East, CIS and Africa. Last, it provides an insight into how human development issues might be looked at in the context of trade development.

Preliminary results from the implementation of this strategy include: discussions by Cambodian rice millers with a Singapore-based company specializing in supply chain management of agriculture products and food ingredients; creation of the Kampong Khlaing Prahoc Orb Association to support production and merchandising of fermented fish



## **Box 1.6: Export Diversification Strategy: The Case of Cambodia (contd.)**

paste; and a needs analysis of the silk industry, pinpointing the areas for improvements in the quantity and quality of mulberry leaves, the breeding and handling of silk worms, and techniques for spinning silk yarn.

Cambodia's example illustrates how a national government, in cooperation with development partners, can build an effective framework for channeling Aid for Trade resources to enable pro-poor growth through trade development.

- i Cambodia is among the top three highly export concentrated developing countries in the region of Southeast Asia after Brunei Darussalam (0.686) and Timor-Leste (0.543), according to UNCTAD's Statistical Database ([www.unctad.org](http://www.unctad.org)).
- ii The IF is a programme of six multilateral agencies — the IMF, ITC, UNCTAD, UNDP, the World Bank, and the WTO — supported by a number of multilateral and bilateral development partners. The IF assists LDCs to integrate more effectively into global trade and turn trade into a driver of national development ([www.enhancedif.org](http://www.enhancedif.org)).

**Source:** Cambodia: Ministry of Commerce and UNDP Cambodia, 2007, *Cambodia's 2007 Trade Integration Strategy: Executive Summary and Action Matrix*, Phnom Penh.; Enhanced Integrated Framework — [www.enhancedif.org](http://www.enhancedif.org); Ministry of Commerce of Cambodia at [www.moc.gov.kh/tradeswap/content/default.aspx?id=14](http://www.moc.gov.kh/tradeswap/content/default.aspx?id=14); ODI, 2009, *An Integrated Approach to Aid for trade: Cambodia Trade Sector-Wide Approach (SWAp)*, ODI, London; UNCTAD, 2011, Statistical Database ([www.unctad.org](http://www.unctad.org)); World Bank, 2011, *World Development Indicators* ([data.worldbank.org](http://data.worldbank.org)).



## Notes

1. Strategic imports are defined as the ratio of imports of energy, food or industrial supplies to GDP.
2. For instance, the export-to-GDP ratio declined for all developing regions from 29.5 percent in 2000 to 28 percent in 2002 on account of the 2001 crisis.
3. 2009 data is unavailable for many Pacific countries.
4. The Export Concentration Ratio (ECR), also known as the Herfindahl-Hirschmann index, is a measure of the degree of market concentration. It has been normalized

$$H_j = \frac{\sqrt{\sum_{i=1}^n \left(\frac{x_i}{X}\right)^2} - \sqrt{1/n}}{1 - \sqrt{1/n}}$$

$$X = \sum_{i=1}^n x_i$$

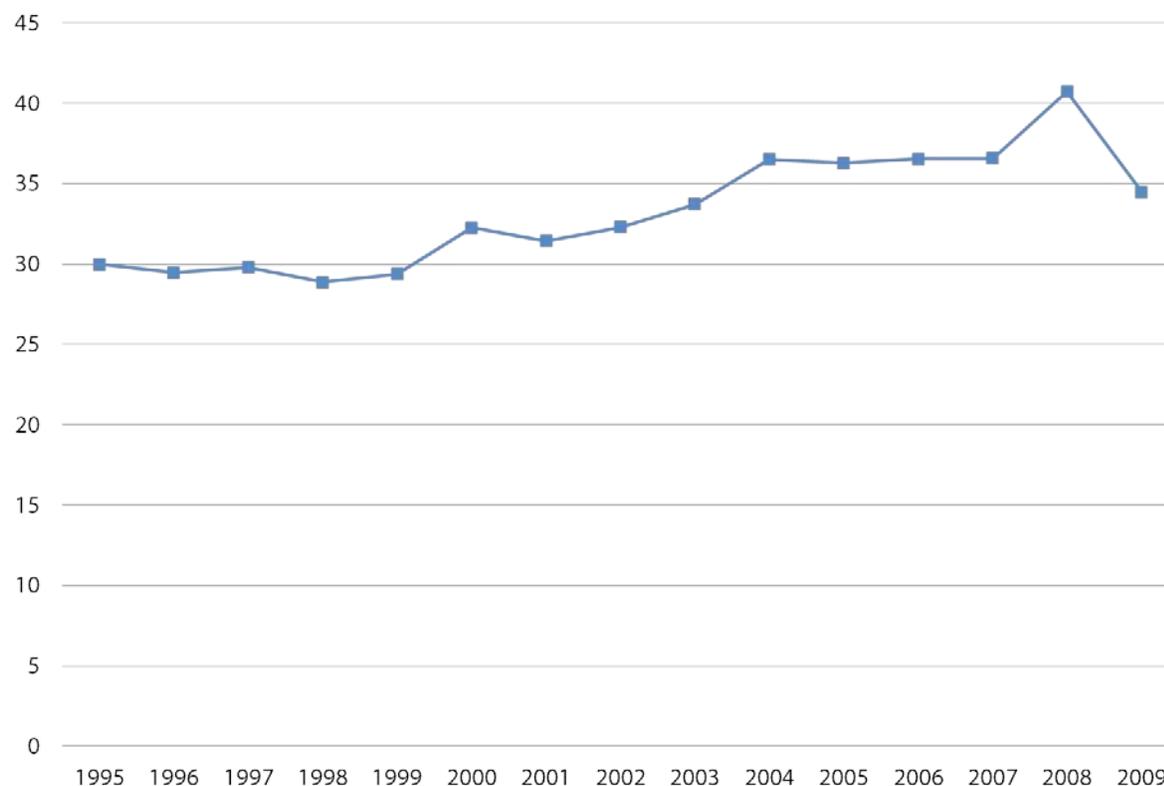
where  $H_j$  is the country or country group index;  $x_i$  is the value of exports of product  $i$ ;  $X$  is the total value of exports; and  $n$  is the number of products. The ECR as defined by UNCTAD only measures merchandise exports and does not include exports of services. The ECR ranges from 0 to 1, with 0 reflecting the least concentrated export portfolio and 1 the most concentrated. See UNCTAD Handbook of Statistics, 2009.

5. The top 25 developing countries with the highest export concentration ratios are: Iraq, Angola, Federated States of Micronesia, Guinea-Bissau, Palau, Chad, Azerbaijan, Nauru, Aruba, Nigeria, Maldives, Yemen, the Sudan, the Libyan Arab Jamahiriya, Saudi Arabia, Islamic Republic of Iran, Mali, Solomon Islands, Equatorial Guinea, Gabon, the Faeroe Islands, Saint-Pierre and Miquelon, the Congo, Kuwait, and São Tomé and Príncipe.
6. UNCTAD's classification of the Asia and Africa regions includes some countries from the Arab States (i.e., the Gulf Cooperation Council (GCC) countries). Disaggregated analysis may well reveal interesting differences in the export portfolios (and export concentration ratios) of GCC countries relative to other Asian exporters.
7. Oil exporters in Africa were especially hard hit in 2009, as their export revenues fell by 40 percent.
8. There are various ways to measure export diversification. The most commonly used measure is the concentration ratio (product or geographic concentration). Other measures used are: the Commodity-Specific Cumulative Export Experience Function (CSCEEF), the Absolute Deviation of the Country Commodity Shares, the Commodity Specific Traditionalist Index (CSTI) and the variance of the CSTI (cf. Samen 2010).
9. Conversely, it has been argued that export concentration limits the productivity spillover into other sectors of the economy, especially when the concentration is in one or two products that have weak linkages to other sectors of the economy (Amin et al. 2000).
10. Since the marginal propensity to consume is higher at lower income levels, economic growth in low-income countries is nearly synonymous with growth in demand.
11. The Arrangement on Guidelines for Officially Supported Export Credits under the aegis of the OECD is also considered as a guiding document for export credit.
12. It should be noted that local content requirements are deregulated under the WTO and many regional trade agreements. While TRIMs and SCM deregulate local content investment measures related to trade in goods, there appear to be no restrictions on the use of local content requirements under the General Agreement on Trade in Services (GATS), although they should be consistent with the national treatment principle. Unlike TRIMs, the basic principles in GATS prohibit any requirement of employment by nationality, unless notified.
13. Aid for Trade commitments to developing countries increased 35 percent in real terms in 2008 to reach a record of almost \$42 billion. However, resources remain concentrated in a few countries: the top 10 recipients account for 45 percent of total commitments, while the LDCs received just 25 percent of total commitments (UN 2010).
14. It has been argued that PTAs that grant preferential access to a narrow range of products can actually limit export diversification. For instance, the preferential treatment for coffee and banana exports from the Caribbean and EU "acted as a disincentive to diversification" (Berezin, Sabehzadeh and Santana 2002). If they are to promote export diversity, PTAs must give preferential access to specific LDCs, with a focus on sectors that LDCs are hoping to promote (e.g., manufacturing; new agricultural products and services) rather than on sectors in which LDCs are already big exporters (namely, primary agricultural or mineral commodities).



## Annex 1.A: Import Dependency

**Chart 1.A1: Imports as a share of GDP in developing economies, 1995–2009 (in percent)**

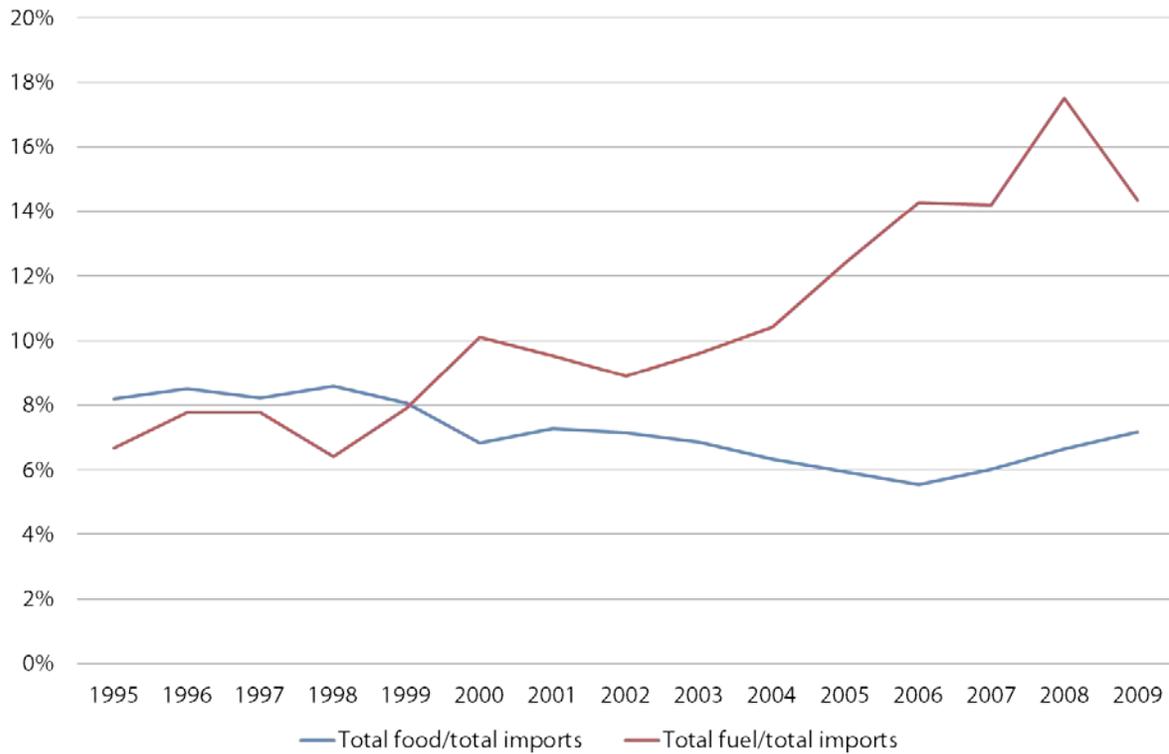


**Source:** Calculated using UNCTAD, *Handbook of Statistics 2011*

Import dependency—measured by the ratio of import values to GDP—increased among developing countries between 1995 and 2008 from 30 percent to 40 percent (Chart 1.A1). The majority of this increase was on account of the growth in dependency on primary commodity imports over the period. However, by 2009, import dependency fell to 34 percent as world trade and commodity prices declined. In 2009, primary commodities accounted for 31 percent of total imports.



**Chart 1.A2: Share of food and fuel imports in total imports into developing countries, 1995–2009**



**Source:** Calculated using UNCTAD, *Handbook of Statistics 2011*

The increased dependency on primary commodity imports is mostly attributed to the growth in fuel imports over the period. Fuel imports as a share of total imports rose from 7 percent in 1995 to 14 percent in 2009 (Chart 1.A2). A combination of rising prices and demand for fuel during the period contributed to this growing “oil-imports dependence.”

Interestingly, food imports decreased as a share of total imports—from 8 percent in 1995 to 7 percent in 2009—as the long-term real price of food has been on the decline. That said, dependence on imports of food remains problematic for some developing economies, such as Small Island Developing Economies, that depend on imports of staple foods. Further, food prices are dependent on climate conditions, which make them particularly vulnerable to short term volatility.

In summary, import dependency among developing countries rose between 1995 and 2009. However, the increase is concentrated in one specific category of commodity imports, namely fuel. Such imports will become increasingly crucial for the health of developing economies, especially with oil prices continuing their steep rise throughout 2010 and 2011.



## Annex 1.B: List of Countries and Territories by Region

Africa			
Algeria	Djibouti	Madagascar	Sierra Leone
Angola	Egypt	Malawi	Somalia
Benin	Equatorial Guinea	Mali	South Africa
Botswana	Eritrea	Mauritania	Sudan
Burkina Faso	Ethiopia	Mauritius	Swaziland
Burundi	Gabon	Morocco	Tanzania
Cameroon	Gambia	Mozambique	Togo
Cape Verde	Ghana	Namibia	Tunisia
Central African Rep.	Guinea	Niger	Uganda
Chad	Guinea-Bissau	Nigeria	Western Sahara
Comoros	Kenya	Rwanda	Zambia
Congo	Lesotho	Sao Tome and Principe	Zimbabwe
Côte d'Ivoire	Liberia	Senegal	
Dem. Rep. of the Congo	Libya	Seychelles	
Latin America and the Caribbean			
Anguilla	Cayman Islands	Grenada	Panama
Antigua and Barbuda	Chile	Guatemala	Paraguay
Argentina	Colombia	Guyana	Peru
Aruba	Costa Rica	Haiti	St. Kitts and Nevis
Bahamas	Cuba	Honduras	St. Lucia
Barbados	Dominica	Jamaica	St. Vincent and the Grenadines
Belize	Dominican Republic	Mexico	Suriname
Bolivia	Ecuador	Montserrat	Trinidad and Tobago
Brazil	El Salvador	Netherlands Antilles	Uruguay
British Virgin Islands	Falkland Islands (Malvinas)	Nicaragua	Venezuela

**Source:** UNCTAD, *Handbook of Statistics 2009*



## Annex 1.B: List of Countries and Territories by Region (contd.)

Asia			
Afghanistan	Iran	Myanmar	Syrian Arab Republic
Bahrain	Iraq	Nepal	Taiwan, Province of China
Bangladesh	Jordan	occupied Palestinian territory	Thailand
Bhutan	Kuwait	Oman	Timor-Leste
Brunei Darussalam	Lao PDR	Pakistan	Turkey
Cambodia	Lebanon	Philippines	United Arab Emirates
China	Macao, SAR of China	Republic of Korea	Viet Nam
Hong Kong, SAR of China	Malaysia	Saudi Arabia	Yemen
India	Maldives	Singapore	
Indonesia	Mongolia	Sri Lanka	
Oceania *			
Cook Islands	Marshall Islands	Northern Mariana Islands	Tokelau
Fiji	Micronesia	Palau	Tonga
French Polynesia	Nauru	Papua New Guinea	Tuvalu
Guam	New Caledonia	Samoa	Vanuatu
Kiribati	Niue	Solomon Islands	Wallis and Futuna Islands
CIS			
Armenia	Kazakhstan	Russian Federation	Ukraine
Azerbaijan	Kyrgyzstan	Tajikistan	Uzbekistan
Belarus	Moldova	Turkmenistan	

\* Also referred to as Pacific Islands in the text.

**Source:** UNCTAD, *Handbook of Statistics 2009*



## Annex 1.C: List of Countries and Territories by Development Status

High-Income Developing Country/ Territory			
American Samoa	Chile	Netherlands Antilles	St. Kitts and Nevis
Anguilla	Cook Islands	New Caledonia	St. Lucia
Antigua and Barbuda	Falkland Islands (Malvinas)	Niue	Taiwan, Province of China
Argentina	French Polynesia	Northern Mariana Islands	Trinidad and Tobago
Aruba	Guam	Oman	Turks and Caicos Islands
Bahamas	Hong Kong, SAR of China	Palau	United Arab Emirates
Bahrain	Kuwait	Qatar	Uruguay
Barbados	Libya Arab Jamahiriya	Republic of Korea	Venezuela
British Virgin Islands	Macao, SAR of China	Saudi Arabia	
Brunei Darussalam	Mexico	Seychelles	
Cayman Islands	Montserrat	Singapore	
Middle-income Developing Country/ Territory			
Algeria	Egypt	Maldives	St. Helena
Belize	El Salvador	Marshall Islands	St. Vincent and the Grenadines
Bolivia	Equatorial Guinea	Mauritius	Suriname
Botswana	Fiji	Micronesia	Swaziland
Brazil	Gabon	Morocco	Syrian Arab Republic
Cape Verde	Grenada	Namibia	Thailand
Colombia	Guatemala	Nauru	Tokelau
Congo	Honduras	occupied Palestinian territory	Tonga
Costa Rica	Iran	Panama	Tunisia
Cuba	Jamaica	Paraguay	Turkey
Dominica	Jordan	Peru	Tuvalu
Dominican Republic	Lebanon	Samoa	Vanuatu
Ecuador	Malaysia	South Africa	Wallis and Futuna Islands
Low-Income Developing Country/ Territory			
Afghanistan	Eritrea	Liberia	Sao Tome and Principe
Angola	Ethiopia	Madagascar	Senegal
Bangladesh	Gambia	Malawi	Sierra Leone
Benin	Ghana	Mali	Solomon Islands
Bhutan	Guinea	Mauritania	Somalia

Source: UNCTAD, Handbook of Statistics 2009



## Annex 1.C: List of Countries and Territories by Development Status (contd.)

Low-Income DC (contd.)			
Burkina Faso	Guinea-Bissau	Mongolia	Sri Lanka
Burundi	Guyana	Mozambique	Sudan
Cambodia	Haiti	Myanmar	Tanzania
Cameroon	India	Nepal	Timor-Leste
Central African Rep.	Indonesia	Nicaragua	Togo
Chad	Iraq	Niger	Uganda
China	Kenya	Nigeria	Viet Nam
Comoros	Kiribati	Pakistan	Yemen
Côte d'Ivoire	Republic of Korea	Papua New Guinea	Zambia
Dem. Rep. of the Congo	Lao PDR	Philippines	Zimbabwe
Djibouti	Lesotho	Rwanda	
LDCs			
Afghanistan	Equatorial Guinea	Maldives	Somalia
Angola	Eritrea	Mali	Sudan
Bangladesh	Ethiopia	Mauritania	Tanzania
Benin	Gambia	Mozambique	Timor-Leste
Bhutan	Guinea	Myanmar	Togo
Burkina Faso	Guinea-Bissau	Nepal	Tuvalu
Burundi	Haiti	Niger	Uganda
Cambodia	Kiribati	Rwanda	Vanuatu
Central African Rep.	Lao PDR	Samoa	Yemen
Chad	Lesotho	Sao Tome and Principe	Zambia
Comoros	Liberia	Senegal	
Dem. Rep. of the Congo	Madagascar	Sierra Leone	
Djibouti	Malawi	Solomon Islands	
Transition Countries			
Albania	Croatia	Montenegro	Tajikistan
Armenia	Georgia	Russian Federation	The FYR of Macedonia
Azerbaijan	Kazakhstan	Serbia	Turkmenistan
Belarus	Kyrgyzstan	Serbia and Montenegro	Ukraine
Bosnia and Herzegovina	Moldova	SFR of Yugoslavia (former)	Uzbekistan

**Source:** UNCTAD, *Handbook of Statistics 2009*



## Annex 1.D: Economic Groupings of Developing Countries and Territories

### *Income Groups*

The country distributions presented are for statistical convenience only and follow those used by the Statistics Division, Department of Economic and Social Affairs (DESA) of the United Nations. The economies are categorized into three groups according to their per capita GDP in 2000. The breakdown is based on GDP and population data available in 2009.

### *2000 per capita current GDP above \$4,500: High-income (41)*

American Samoa, Anguilla, Antigua and Barbuda, Argentina, Aruba, Bahamas, Bahrain, Barbados, British Virgin Islands, Brunei Darussalam, Cayman Islands, Chile, Cook Islands, Falkland Islands (Malvinas), French Polynesia, Guam, Hong Kong (Special Administrative Region of China), Kuwait, the Libyan Arab Jamahiriya, Macao (Special Administrative Region of China), Mexico, Montserrat, Netherlands Antilles, New Caledonia, Niue, Northern Mariana Islands, Oman, Palau, Qatar, the Republic of Korea, Saint Kitts and Nevis, Saint Lucia, Saudi Arabia, Seychelles, Singapore, Taiwan (Province of China), Trinidad and Tobago, Turks and Caicos Islands, the United Arab Emirates, Uruguay, Bolivarian Republic of Venezuela.

### *2000 per capita current GDP between \$1,000 and \$4,500: Middle-income (52)*

Algeria, Belize, Bolivia, Botswana, Brazil, Cape Verde, Colombia, the Congo, Costa Rica, Cuba, Dominica, the Dominican Republic, Ecuador, Egypt, El Salvador, Equatorial Guinea, Fiji, Gabon, Grenada, Guatemala, Honduras, Islamic Republic of Iran, Jamaica, Jordan, Lebanon, Malaysia, Maldives, the Marshall Islands, Mauritius, Federated States of Micronesia, Morocco, Namibia, Nauru, occupied Palestinian territory, Panama, Paraguay, Peru, Saint Helena, Saint Vincent and the Grenadines, Samoa, South Africa, Suriname, Swaziland, Syrian Arab Republic, Thailand, Tokelau, Tonga, Tunisia, Turkey, Tuvalu, Vanuatu, Wallis and Futuna Islands.

### *2000 per capita current GDP below \$1,000: Low-income (63)*

Afghanistan, Angola, Bangladesh, Benin, Bhutan, Burkina Faso, Burundi, Cambodia, Cameroon, the Central African Republic, Chad, China, the Comoros, Côte d'Ivoire, the Democratic People's Republic of Korea, the Democratic Republic of the Congo, Djibouti, Eritrea, Ethiopia, Guinea, the Gambia, Ghana, Guinea-Bissau, Guyana, Haiti, India, Indonesia, Iraq, Kenya, Kiribati, the Lao People's Democratic Republic, Lesotho, Liberia, Madagascar, Malawi, Mali, Mauritania, Mongolia, Mozambique, Myanmar, the Niger, Nigeria, Nepal, Nicaragua, Pakistan, Papua New Guinea, the Philippines, Rwanda, São Tomé and Príncipe, Senegal, Sierra Leone, Solomon Islands, Somalia, Sri Lanka, the Sudan, Timor-Leste, Togo, Uganda, the United Republic of Tanzania, Viet Nam, Yemen, Zambia, Zimbabwe



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