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Structural transformation in Asia's landlocked developing countries

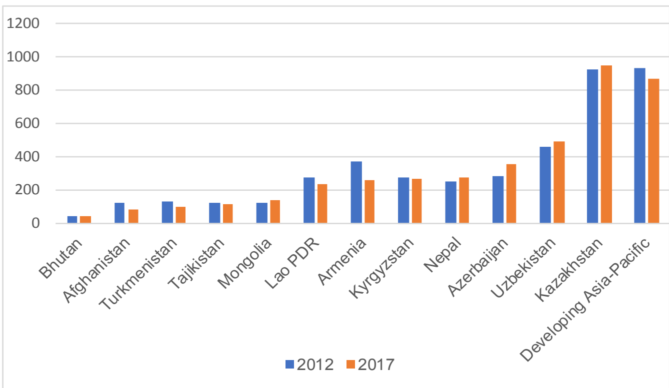
Asia's landlocked developing countries (LLDCs) are a heterogeneous group that differ in various dimensions, including development needs. For instance, some countries have transformed from a centrally-planned, state-command model to a market based one; many are resource dependent and have very concentrated production structures; four of them belong to the group of least developed countries (LDCs). *Asia-Pacific Countries with Special Needs Development Report: Structural Transformation and its Role in Reducing Poverty* provides an in-depth analysis on policy options for LLDCs. It highlights that for resource-based economies the process must involve economic diversification away from extractive industries, as the natural resource dependence exposes them to external shocks and macroeconomic imbalances; in least developed landlocked countries a shift of employment from agriculture to manufacturing must take place to increase productivity and reduce poverty. Industrialization is of paramount importance as a thriving labour-intensive manufacturing base is best at generating productive employment. More productive employment means higher remuneration, which in turns means less poverty. In some particular cases, the shift from agriculture to services might indeed be the only direction possible, if factors such as small size of an economy, limit opportunities to develop a manufacturing base. In general, this process however should be discouraged, as it inhibits the creation of productive jobs and slows the pace of poverty reduction. This is because employment in the manufacturing sector can be several times more productive than in services, particularly informal services. Hence the shift towards manufacturing allows for greater reduction in poverty.

Early de-industrialization and primivitization of the industrial base

In many LLDCs, the remoteness from international markets and high costs associated with transport to engage with the global economy limit incentives for economic diversification and development of new industries. This often exacerbates reliance on extractive industries. The consequent high concentration of exports, demonstrated by a low number of export products (figure 1) and a low and declining number of market destinations (figure 2), prevents these economies from broader participation in international trade through, for example, global and regional value chains. This impedes the developmental advancements.

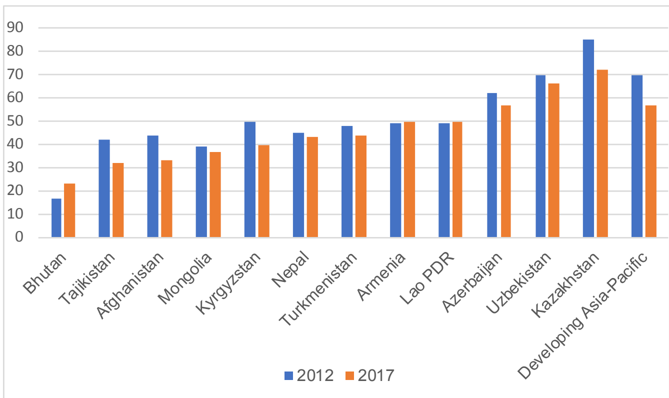
Moreover, whereas the share of employment in manufacturing had tended to peak at around 30 per cent of the workforce in early industrializers, this share has declined in economies that have industrialized later[1]. Indeed, manufacturing has been found to peak at a much lower share of around 16 per cent[2]. As a result of such premature de-industrialization, many LLDCs have moved towards services at a much earlier stage of development, with much lower levels of per capita income[3].

Figure 1. Export concentration (number of products)



Source: ESCAP's calculation based on data from Trade Outcomes Indicators available from WITS.

Figure 2. Export concentration (number of markets)



Source: ESCAP's calculation based on data from Trade Outcomes Indicators available from WITS.

In Asia's LLDCs that have undergone a systemic transformation from a centrally-planned, state-command model, another phenomenon occurred, namely industrial primitivization[4]. This refers to a situation in which industrial sectors with more value addition gave way to those with less value-added. One reason that this happened is because of "development illusion", in which state-command economies invested significant resources in capital-intensive sectors (such as heavy and chemical industries (HCI)), omitting low-tech, labour-intensive industries in their development paths. By doing so, they created a temporary illusion that the stage of labour-intensive development had already been surpassed. Yet, once their economic systems were transformed and the post-state-command economies engaged with the global economy following market rules, their inefficient and ineffective heavy and chemical industries were unable to compete in global markets. Moreover, as these economies desperately needed to decrease high levels of unemployment (a side-effect of early systemic reforms), low-tech, labour-intensive sectors became attractive. The shift of the labour force to low-tech, low capital-intensive sectors consequently had a negative impact on labour productivity, which contributed to a lowering of standards of living.

Industrial restructuring and economic diversification

Among Asia's landlocked developing countries, development policies aimed at structural transformation should focus on economic diversification away from extractive industries. In those that are also classified as least developed countries, greater efforts are needed to strengthen rural development. Development of a labour-intensive manufacturing sector must be a priority, wherever possible. In some cases, a transformation from agriculture to services may be desirable if developing a significant manufacturing sector is unrealistic, as in the case of the smaller countries. In any case, structural transformation must contribute to growth in productivity, and avoid replacing low-productive agriculture with low-productive services.

Moreover, these policies need to facilitate the domestic business sector's development and its engagement with regional value chains to increase access to global markets as the private sector needs to play a key supportive role in ensuring an effective development trajectory. Strategizing foreign direct investments (FDI) that contribute to the expansion of the domestic private sector is necessary, as uncontrolled investment may cause as much harm as sectoral inaction. This is particularly true in resource-rich economies, where FDI in extractive resource sectors has tended to lock the economy into a low-value, often environmentally harmful, segment of production. Moreover, environmental degradation caused by extractive industries must be addressed through effective policies, which may include more stringent environmental laws and regulations, more thorough licencing procedures, the introduction of new technologies and planning for an eventual phasing out of environmentally harmful mining activities.

Structural transformation in some LLDCs that have undergone systemic transition may also need to involve a restructuring of capital-intensive industries – usually heavy and chemical industries and machinery, a reminisce of the old industrial structures. There are various ways of addressing the issue: (a) through scaling down or closing down the heavy and chemical industries; (b) through reconstruction efforts either with a support of FDI, with technology requirements, aimed at sectoral modernisation to increase productivity and to improve environmental sustainability, or through substantial domestic investments in the HCI sector[5]. Among the countries in system transformation from central planning, the first option was often preferred at the beginning of transition, whereas the second one at the later stages of reforms. Indeed, the second option, with the FDI content, appears to be the most adequate as it allows for sectoral modernisation, preservation of workplaces, and improvement in human capital, building capacity to compete in the global economy at relatively lower costs.

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[1] Dani Rodrik, *Straight Talk on Trade: Ideas for a Sane World Economy* (Princeton, Princeton University Press, 2018).

[2] Jesus Felipe, Aashish Mehta and Changyong Rhee, *Manufacturing Matters… but it's the Jobs that Count*, Cambridge Journal of Economics, 43:139-168 (Cambridge, 2018).

[3] United Nations Economic and Social Commission for Asia and the Pacific (ESCAP), *Asia-Pacific Countries with Special Needs Development Report 2015: Building Productive Capacities to Overcome Structural Challenges*, Sales No. E.15.II.F.9 (Bangkok, 2015).

[4] Vladimir Popove and Anisuzzaman Chowdhury, "What can Uzbekistan tell us about industrial policy that we did not already know?", *DESA Working Paper No. 147* (New York, the United Nations, 2016).

[5] Andrzej Bolesta, *China and Post-Socialist Development* (Bristol, United Kingdom, Policy Press, 2015).

The MPFD Policy Briefs aim at generating forward-looking discussions among policymakers, researchers and other stakeholders to help forge political will and build a regional consensus on needed policy actions and pressing reforms. Policy Briefs are issued without formal editing. The content of this issue, prepared by Andrzej Bolesta, is in part based on material from the *Asia-Pacific Countries with Special Needs Development Report: Structural Transformation and its Role in Reducing Poverty* (Sales No. E.19.II.F.5). This policy brief benefited from comments by Oliver Paddison and Yusuke Tateno, under the guidance of Hamza Ali Malik. For further information on this issue, please contact Hamza Ali Malik, Director, Macroeconomic Policy and Financing for Development Division, ESCAP (escap-mpdd@un.org).