



**Expert Group Meeting:
Structural transformation and poverty reduction
in the Asia-Pacific countries with special needs**

Session 1 - Overview of the Asia-Pacific Countries with Special Needs
Development Report 2019

Monday, 12 November 2018

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Introduction to Countries with Special Needs (CSN)

Background information on topic:

- What and why?

Assessment of structural transformation (ST) in CSN

- Sectors, employment, productivity

The nexus: ST and poverty reduction

- Channels, conditions, patterns
- Poverty reduction in CSN - where is it concentrated?

Policy recommendations

Introduction

Countries with special needs (CSN)

- Include LDCs, LLDCs and SIDS
- Continue to face structural challenges and vulnerability to external shocks

The Asia-Pacific CSN Development Report

- 2015: Building productive capacities to overcome structural challenges
- 2016: Adapting the 2030 Agenda for Sustainable Development at the National Level
- 2017: Investing in infrastructure for an inclusive and sustainable future
- 2018: Preventing conflict and sustaining peace to foster sustainable development
- **2019: Structural transformation and its role in poverty reduction**

Introduction

What is ST?

- Defined as the change in the long-term composition and distribution of economic activities
- Traditionally from agriculture to manufacturing and then to services
- Involves both within- and across-sector changes

What causes ST?

- Push/Supply Side: Capital stock, productivity
- Pull/Demand Side: Income growth and increasing demand for income-elastic goods, changes in resource availability, technology, etc.

Why is it important?

- ST results in higher productivity gains, higher wages and stable sources of incomes, thereby reducing poverty and closing productivity gaps across sectors

Introduction

What is the relevance to CSN?

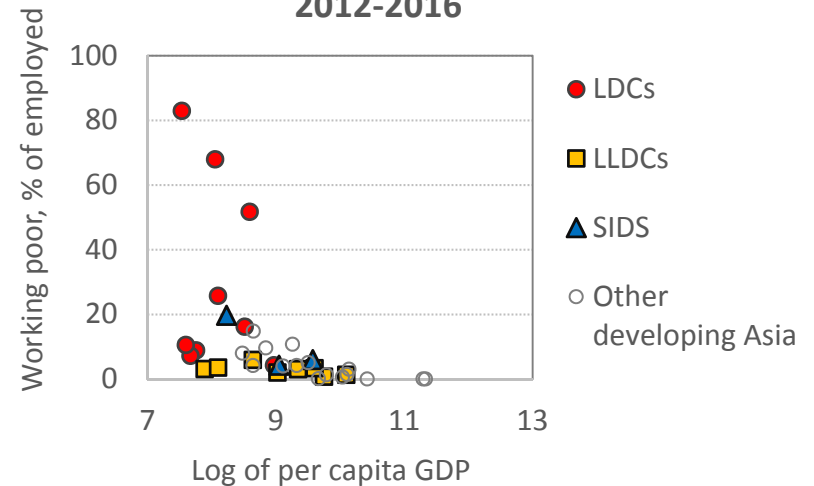
- Poverty, productivity gaps across sectors, rural-urban gaps
- ST in CSN is still in its formative stages



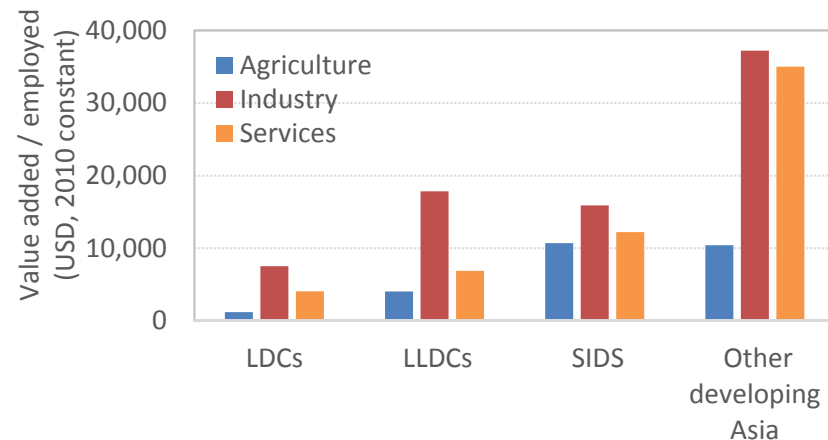
Potential gains of ST may be significant for CSN

- Global programmes of action for CSN (IPoA, VPoA, SAMOA Pathway) and the 2030 Agenda for Sustainable Development (SDGs)
- Some CSN have recently faced unconventional structural shifts – *premature deindustrialization*

Poverty and GDP per capita, average of 2012-2016



Labour productivity, by sector and by country group, average of 2007-2016



Introduction

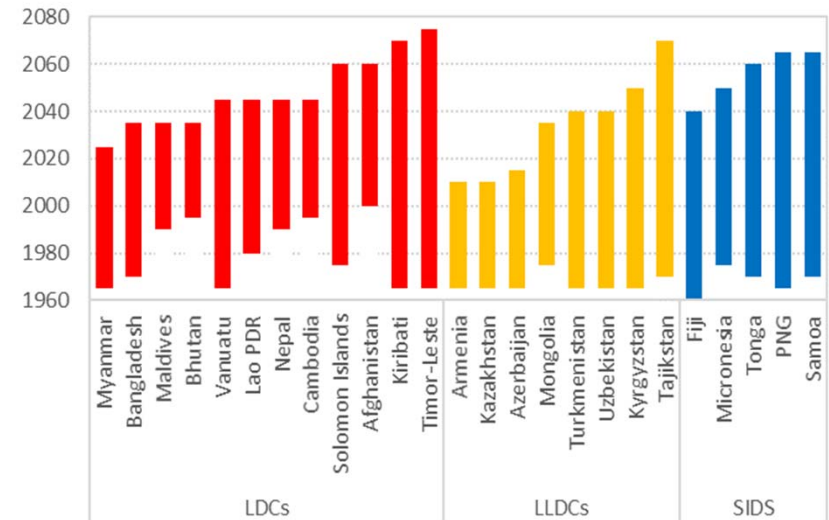
The *Report* aims to:

- Assess the trajectory of ST and its role in eradicating poverty in CSN
- Identify the appropriate channels and conditions under which ST contributes to poverty reduction
- Address whether the traditional approach of ST is still a valid pathway for CSN given:
 - Increasing pace of technological advancement
 - Youth bulge and prospects for creating conditions for decent job opportunities
 - Broader objectives of social inclusiveness and environmental sustainability in the SDG era

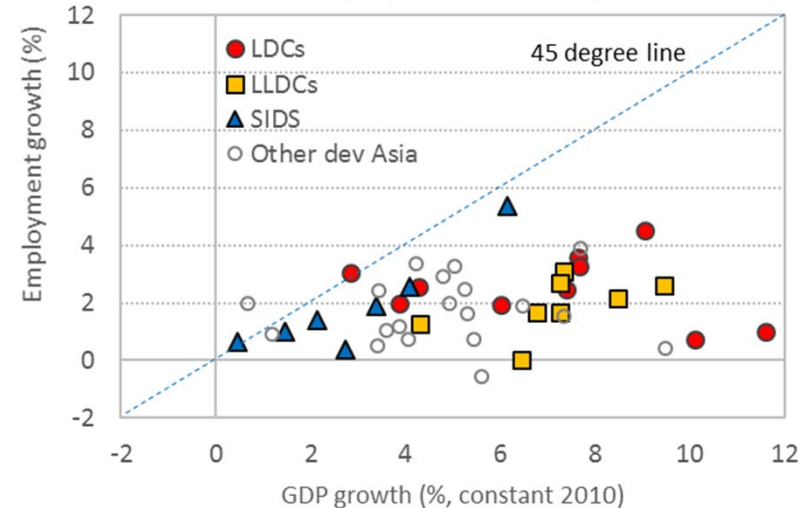
The *Report*

- Describes the stages and patterns of ST in CSN (Ch.1)
- Explores the linkages between poverty reduction and ST (Ch.2)
- Provides recommendations and addresses the role of cooperation and integration (Ch.3)

Years in which working age populations are growing



Growth of employment and GDP, 2000-2016



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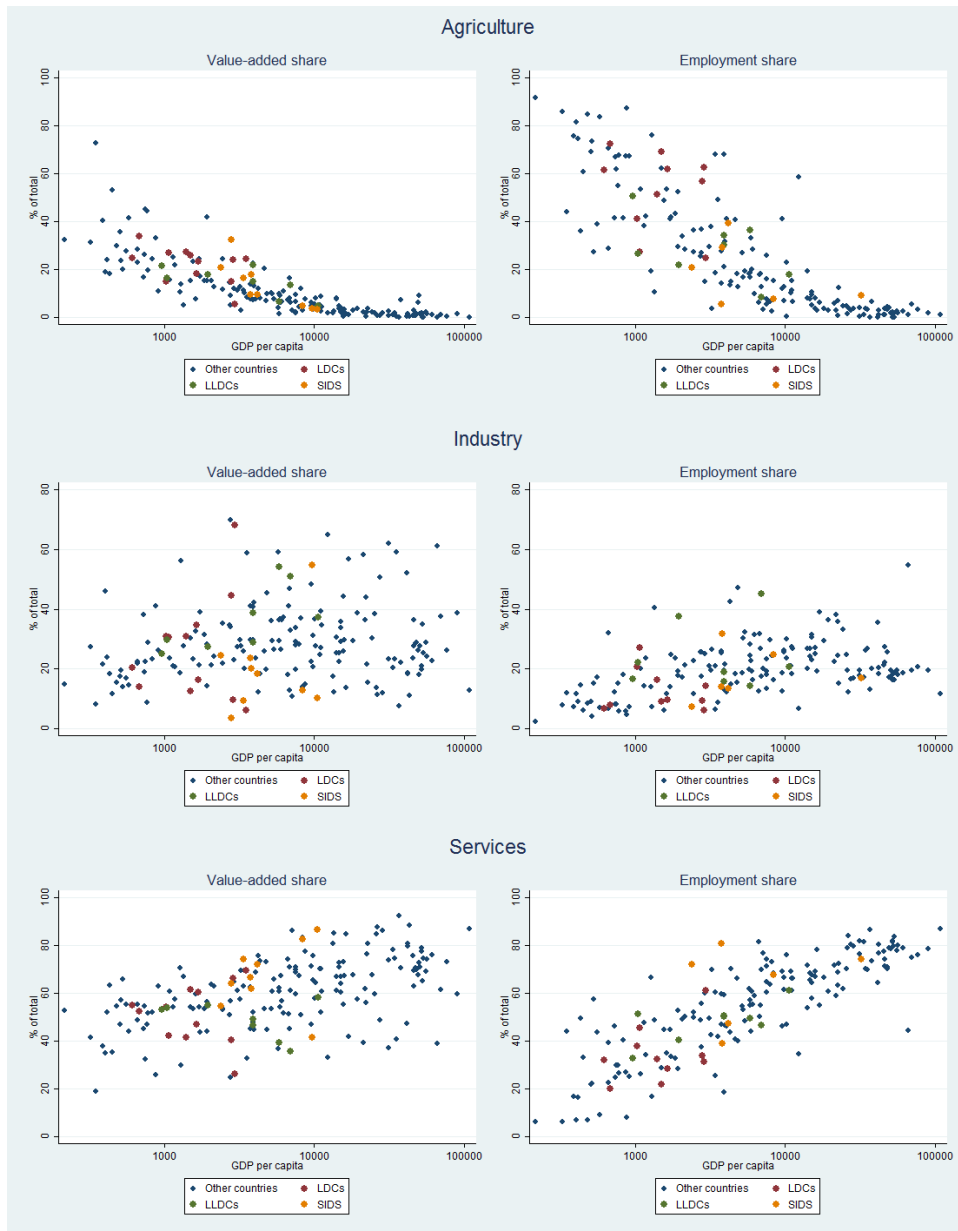
- Sectors, employment, productivity

The nexus: ST and poverty reduction

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Policy recommendations

Structural transformation in Asia and the Pacific



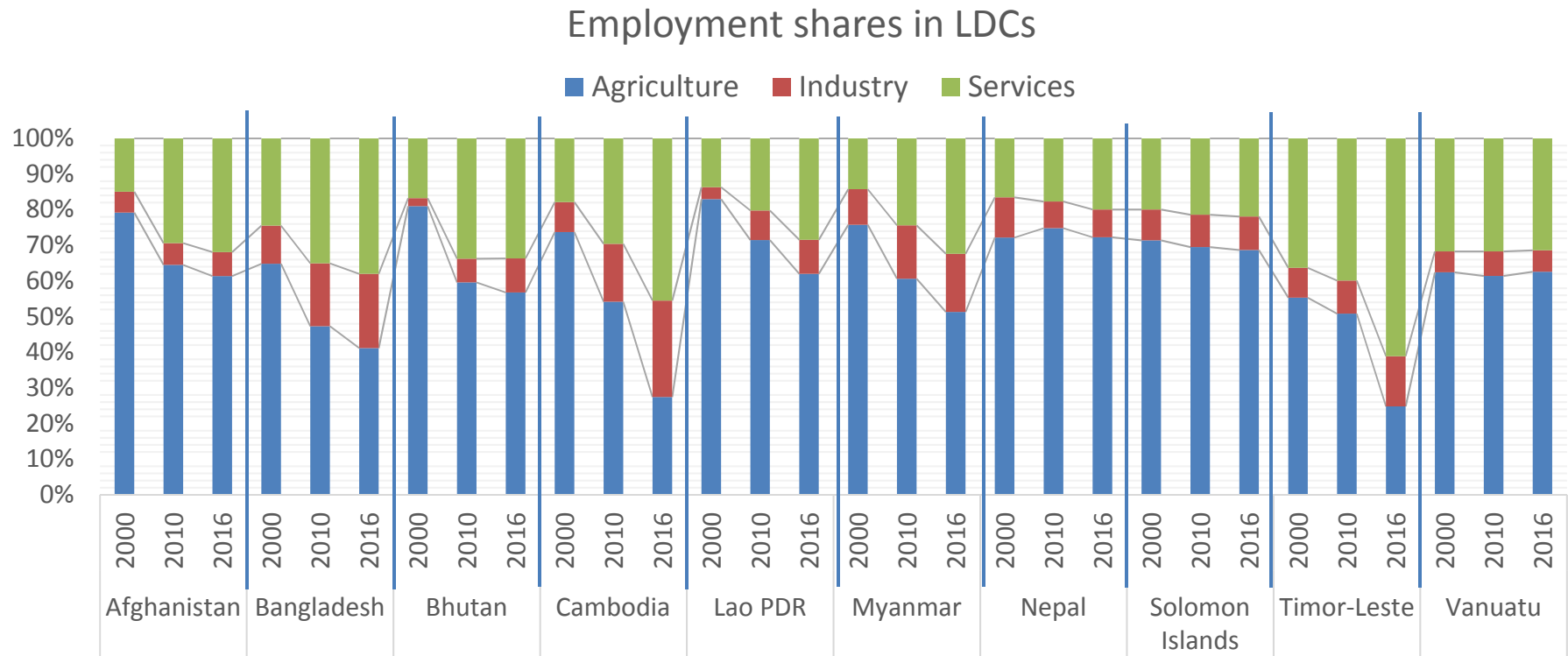
- Two common measures of ST: employment shares and value-added shares, but with some caveats
- As per capita incomes rise, the decline in the employment and value-added share of agriculture and the increase in the share of services is a visible and consistently observed phenomenon.
- Industry exhibits more of a reverse U shape
- Lower income countries suffer from an asymmetry between the low output share of value added and high share of employment in Agriculture

Assessment of ST in CSN

Structural transformation: Where do CSN stand (in terms of employment share)?

- (Kunal Sen, 2017):
 - Structurally underdeveloped: Agriculture > Industry and services
 - Structurally developing: Services > Agriculture > Industry
 - Structurally developed: Services > Industry > Agriculture

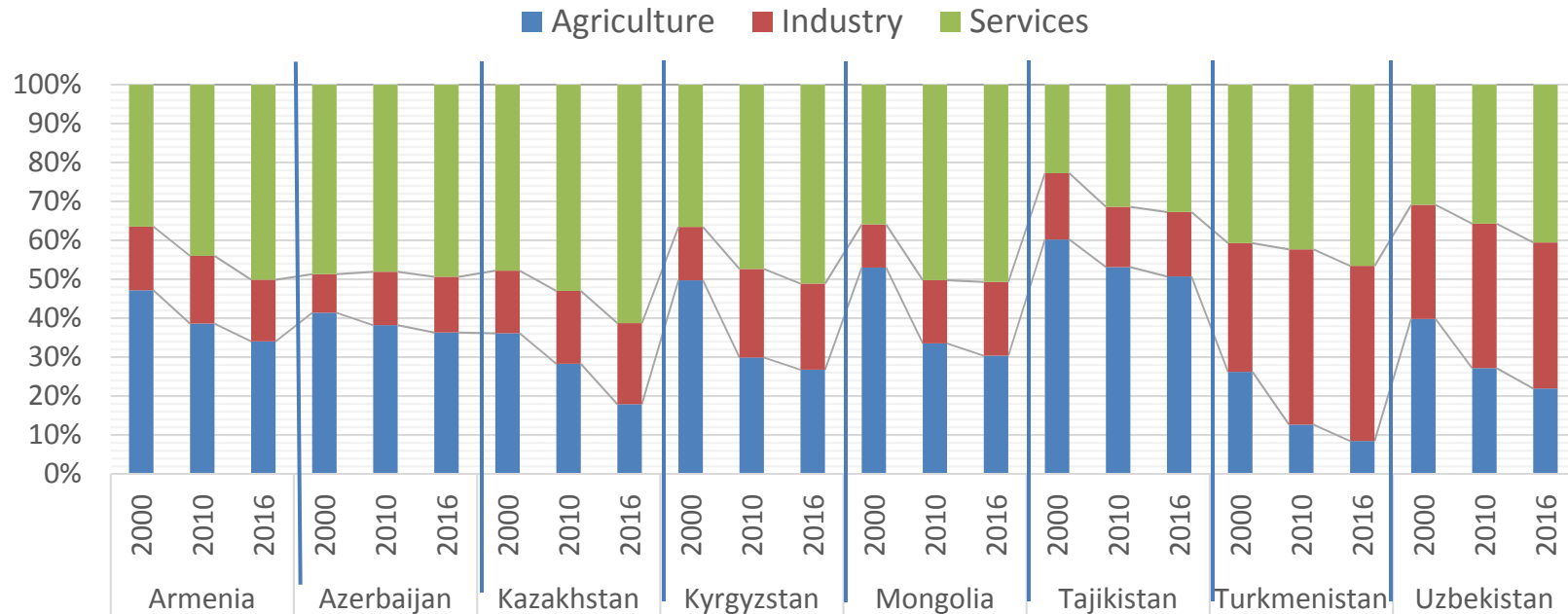
Most LDCs are structurally underdeveloped



- Most LDCs are still “structurally under-developed” as agriculture is the largest sector in terms of the number of employed.
 - Movement out of Agriculture is still slow
 - Nepal, Solomon Islands, Vanuatu have been particularly slow
- Cambodia and Timor-Leste are outliers where the service sector is particularly large
 - In the case of the former employment in industry and agriculture are also comparable

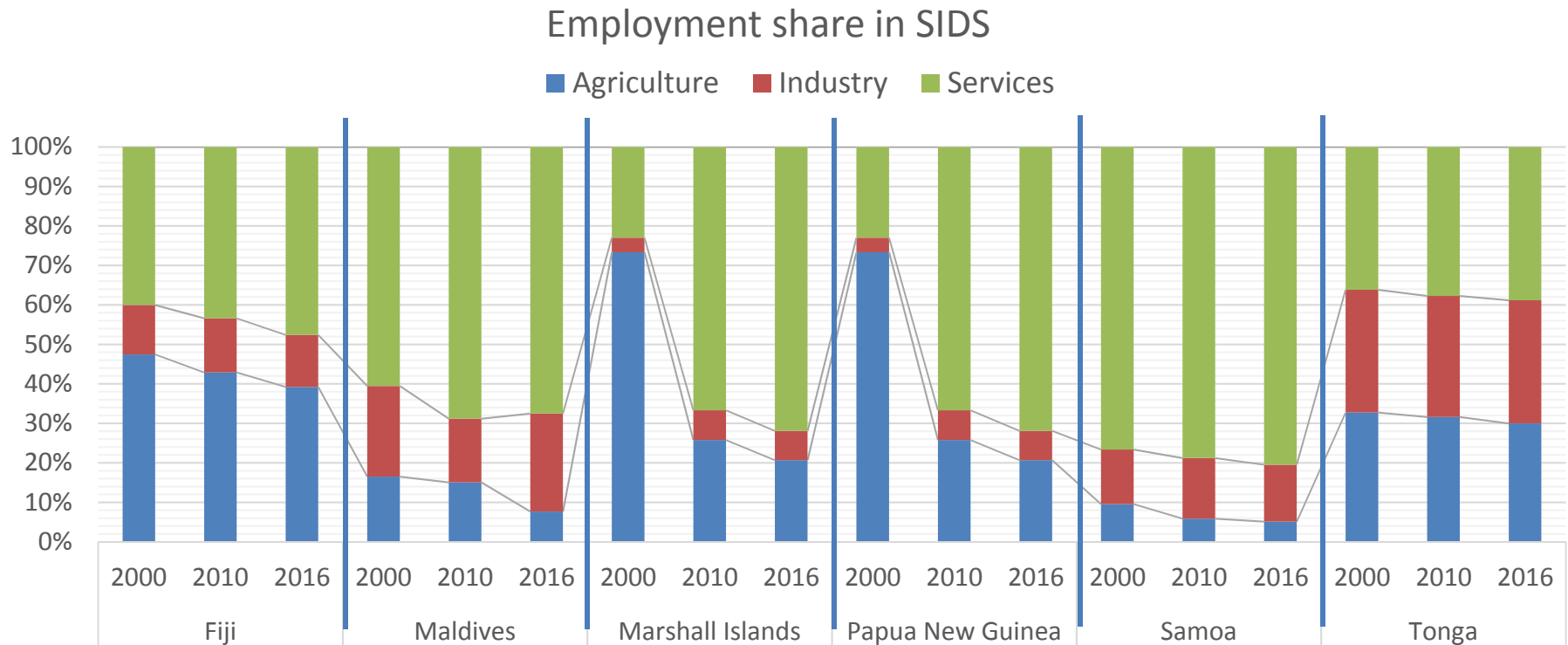
Most LLDCs are structurally developing

Employment shares in LLDCs



- Most LLDCs are considered “structurally developing” as services have emerged as the largest sector in terms of employed while the share of industry is still less than that of agriculture.
 - However in Kazakhstan, Turkmenistan and Uzbekistan, Industry has already surpassed agriculture and they could technically be categorized as structurally developed

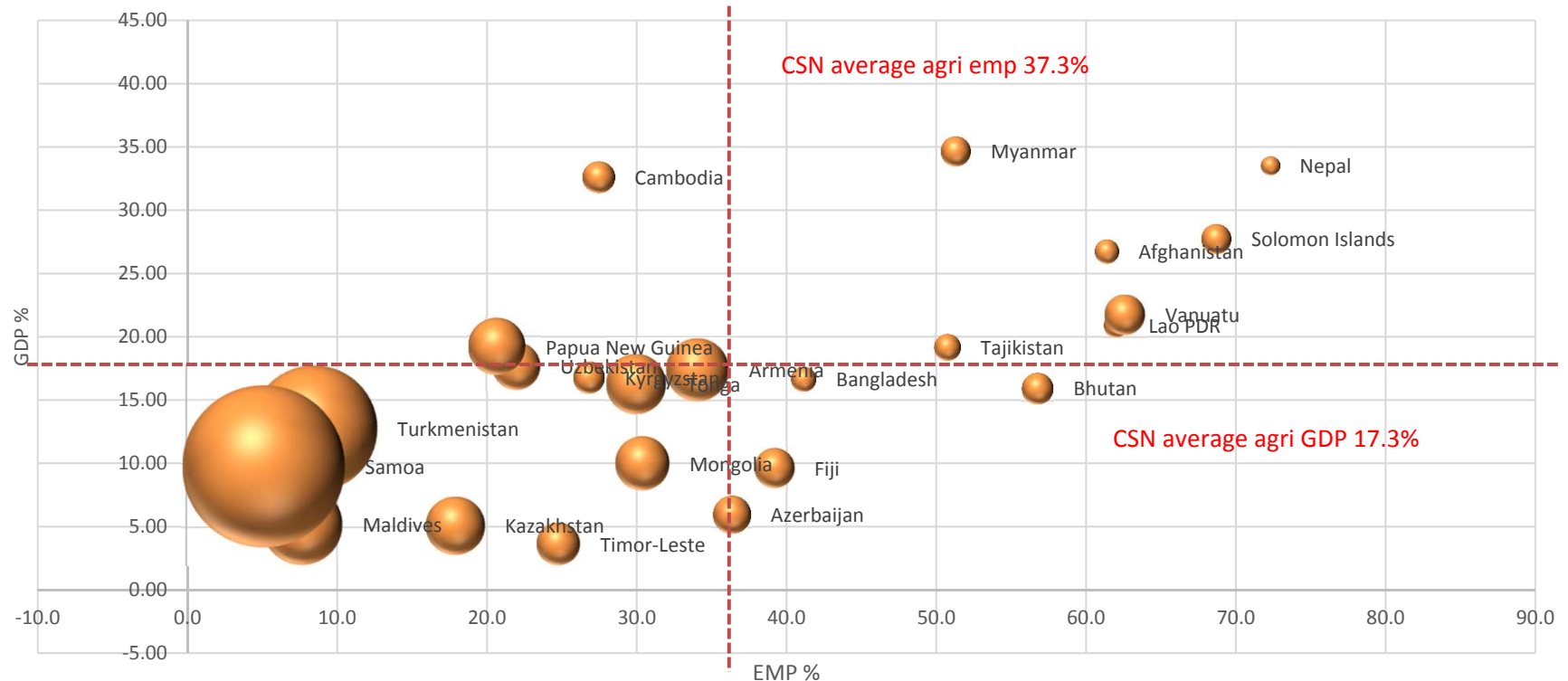
SIDS are structurally developed and developing



- SIDS are a combination of “structurally developing” and “developed”.
 - Fiji, Marshall Islands and PNG are still developing with large service sectors
 - In Maldives, Samoa and Tonga, Industry although small is larger than the very small Agriculture sector

Potential for gains from structural transformation

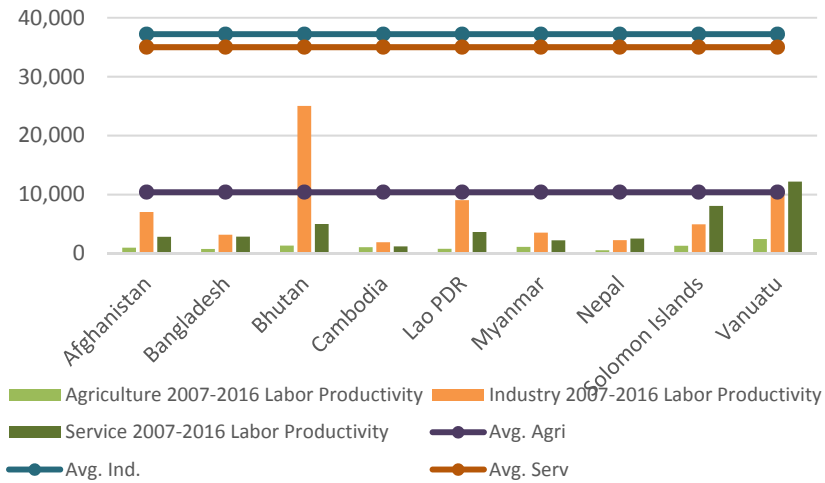
Agri GDP vs Agri Emp (Bubble size reflects Agri Labour Productivity)



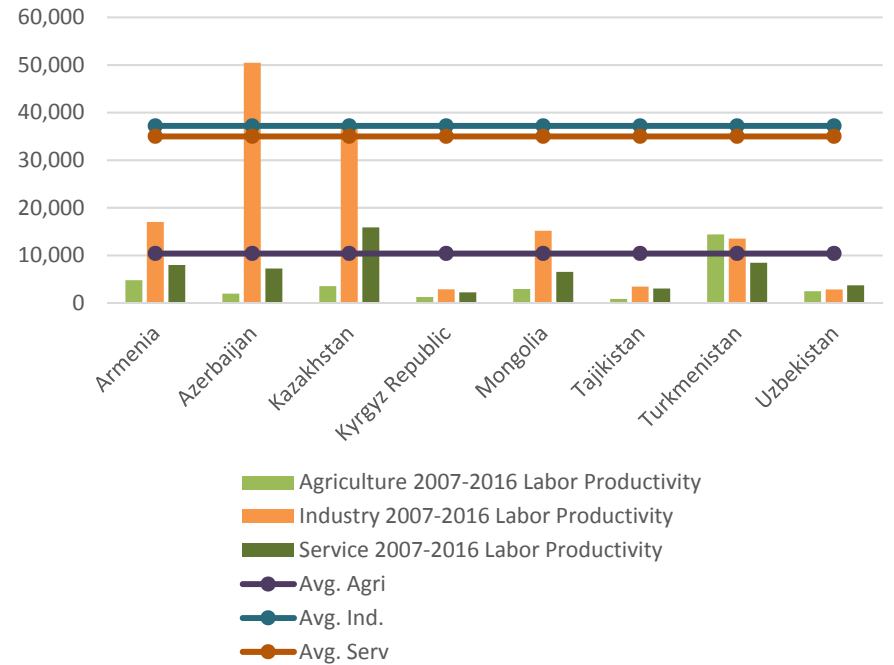
- Countries in the upper right quadrant stand to gain the most from reallocation
 - Employment and GDP shares are higher than average.
 - Labour productivity in the sector is also low.

Productivity variation (Current USD)

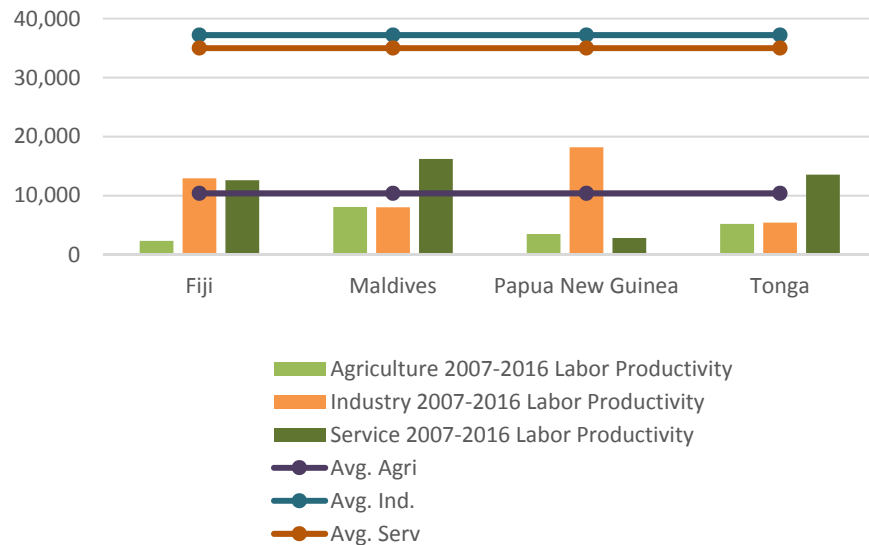
Productivity gaps across sectors in LDCs



Productivity gaps across sectors in LLDCs



Productivity gaps across sectors in SIDS

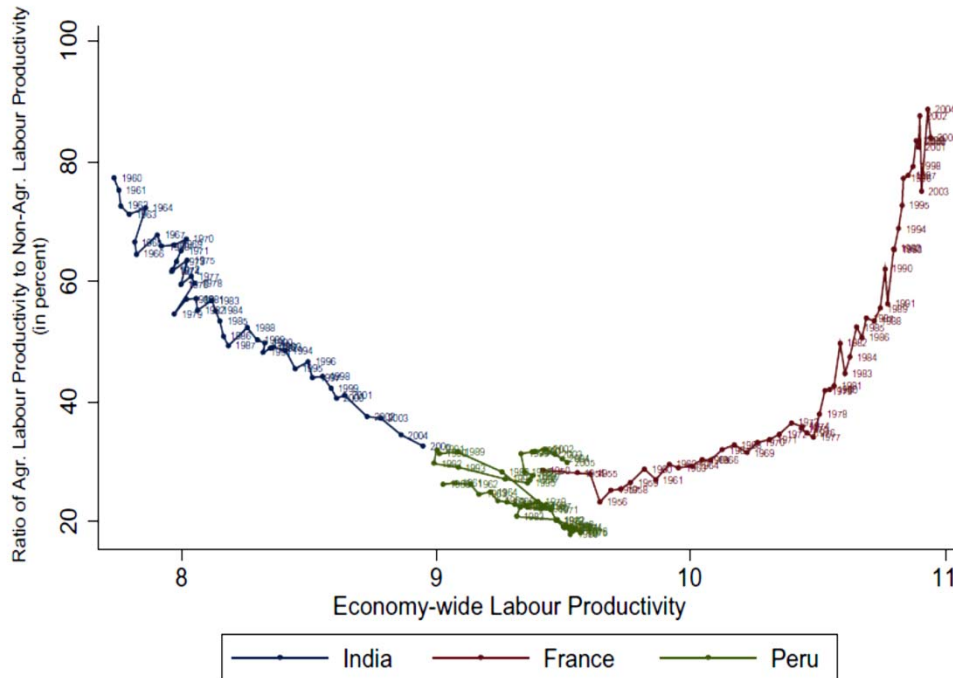


Large productivity gaps across sectors



Reallocation can be an important source of growth

Importance of agricultural productivity



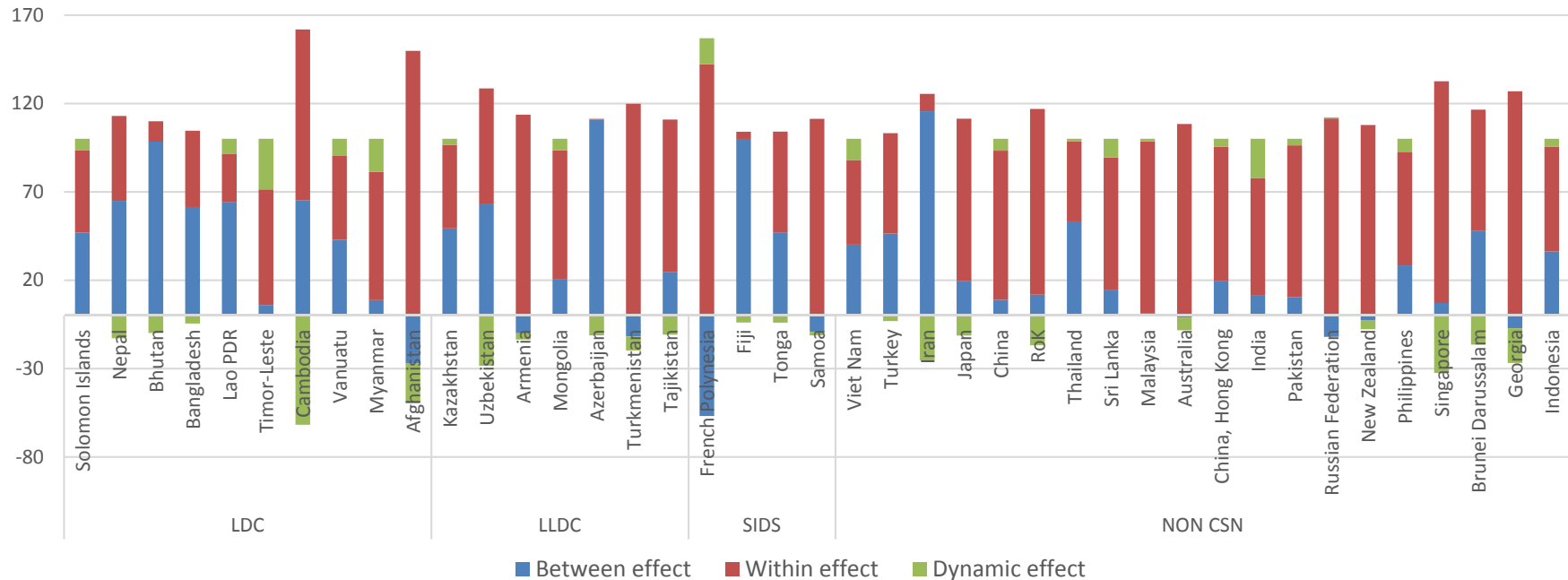
Timmer's four phases:

- Beginning
- Agricultural Surplus
- Integration
- Industrialization

- Stylized fact: productivity gap between agriculture and non-agriculture sector exhibits a u-shaped trajectory.
- It is a crude representation of the stages of structural transformation and captures 2 key dynamics in the process
 - The rise of new industries and the movement of resources from traditional sectors to newer ones.
 - This is critical since most CSNs are still trapped in the initial phases

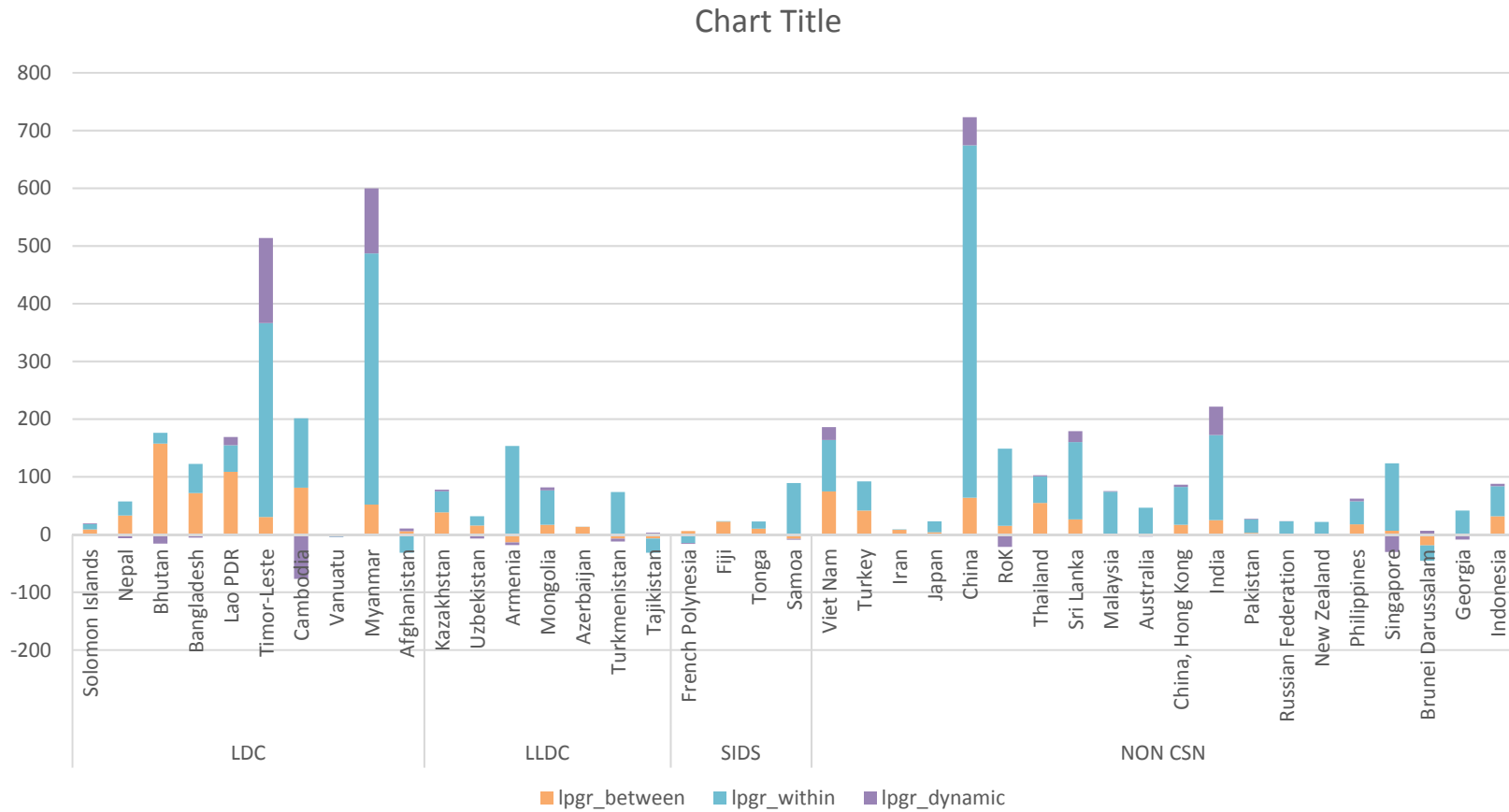
Sources of labour productivity growth in CSN

Decomposition of labour productivity growth, 1991-2016



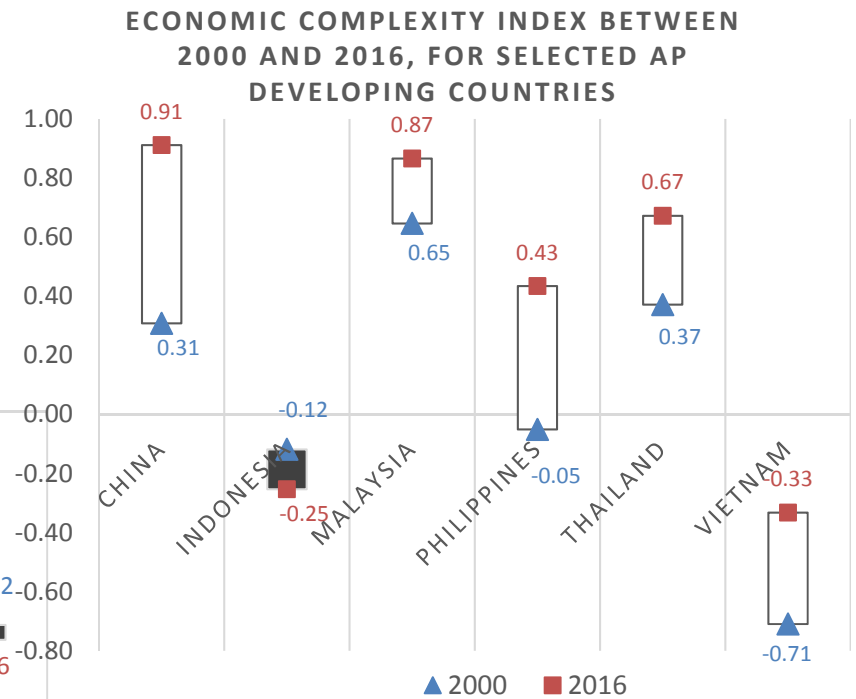
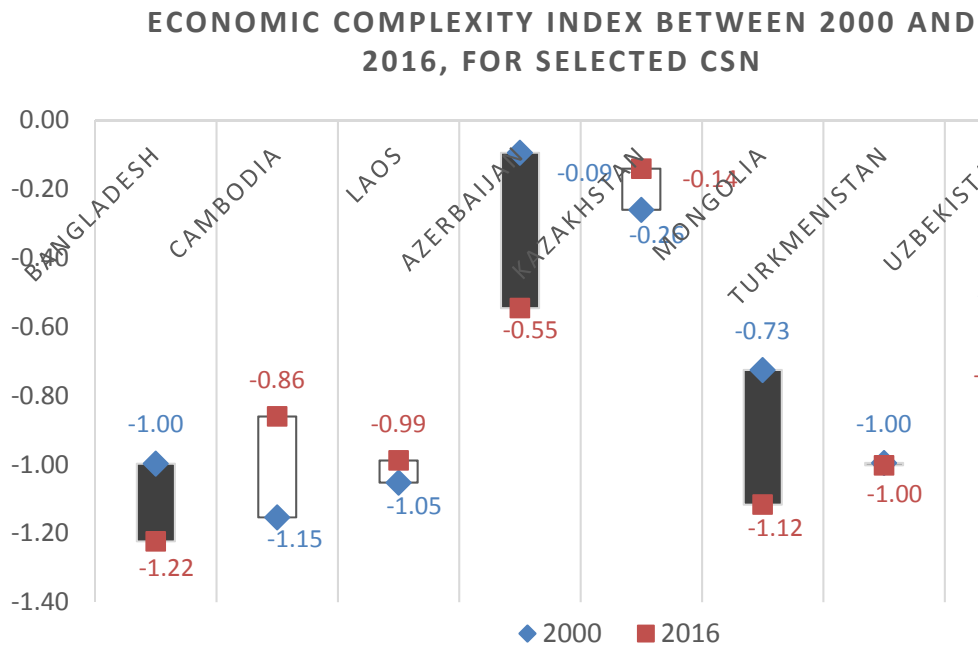
- **Non CSN:** Perhaps the structural transformation dividend was realized earlier and does not show up in the data for this time period.
- **CSN:** Between effect is strong. Perhaps this suggests that more capital deepening or upgradation is needed in CSN.
- **In some CSN:** a negative contribution of structural transformation; perhaps labour moved to lower productivity sectors like in Aghanistan where conflict may have induced this outcome.

Absolute growth in labour productivity



Are CSN upgrading their product sophistication?

- Unfortunately, ECI has decreased for quite a few
- Cambodia, which also has higher share of industry in GDP has shown the most improvement
- All CSN still have much lower than average ECI



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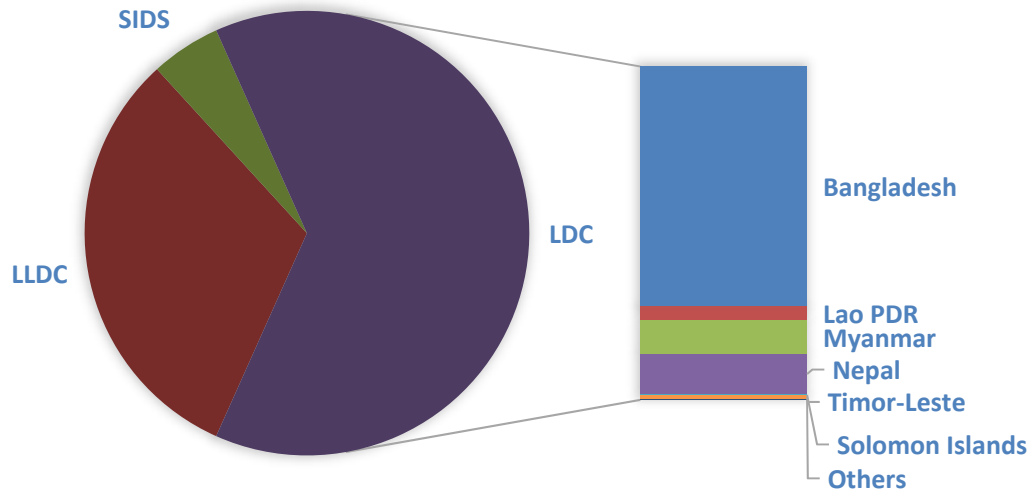
The poverty reduction-ST nexus

- Growth on its own is not sufficient and the composition matters for poverty reduction
- Impacts also depend on employment elasticity of growth in sectors and growth elasticity of poverty reduction
 - Significant heterogeneity in sectorial elasticities
 - Highest in trade and transport services
- Unskilled labour intensive sectors contribute the most as unskilled labour is the input the poor can offer to the production process (Loayza & Raddatz, 2010)
- Numerous empirical studies indicate that growth in Agriculture and related agribusiness is on average more effective in reducing income poverty (Dorosh & Thurlow, 2018; Ivanic & Martin, 2018)
- Structural transformation that pulls unskilled workers from low productivity sectors to higher productivity sectors is likely to have the greatest impact on poverty reduction (Kumar & Aggarwal, 2012)
- When agricultural productivity increases poor households may gain as producers directly if costs fall faster than prices, or indirectly as consumers through lower prices or as labourer through higher wages.

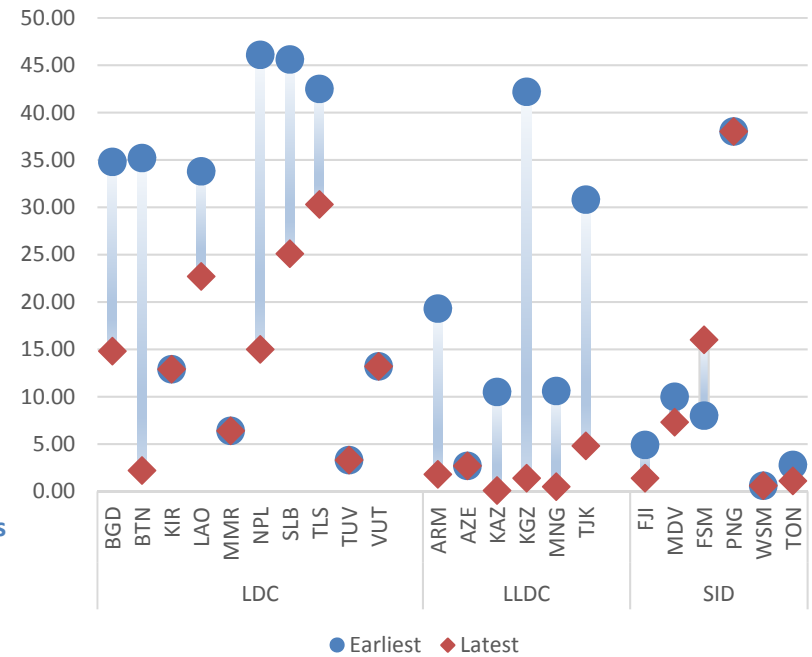
Status of poverty reduction

- Poverty has generally trended downwards
 - Still high in some LDCs mostly
 - Rural dimensions of poverty

DISTRIBUTION OF POVERTY ACROSS CSN (LATEST AVAILABLE DATA FOR USD 1.90)



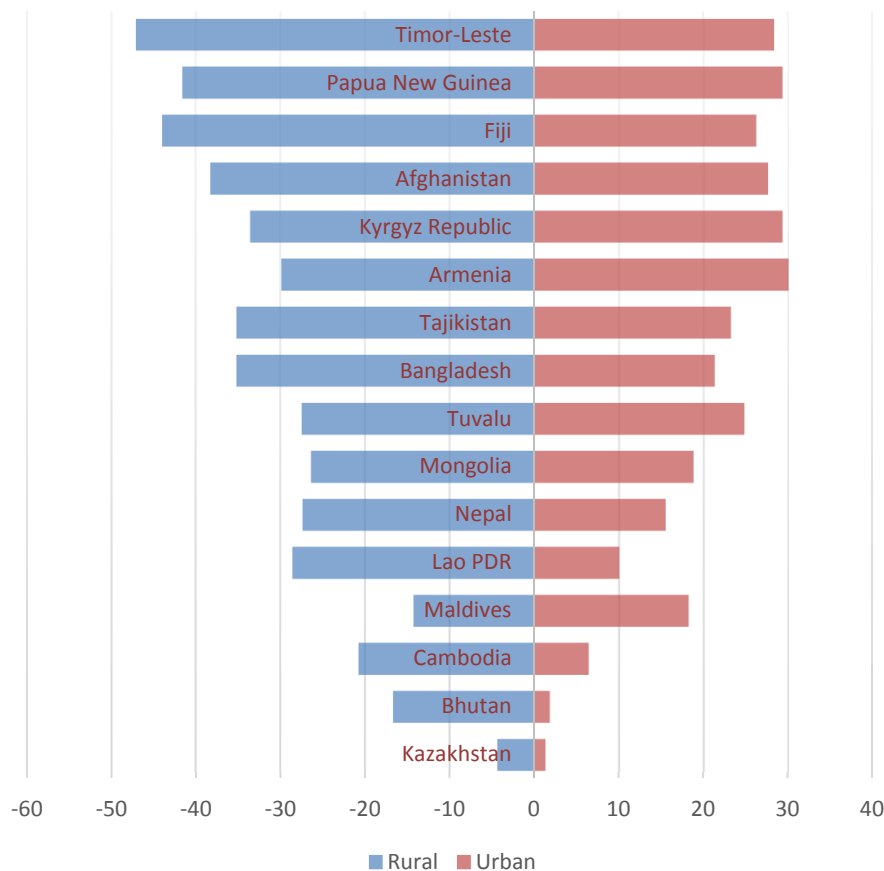
Poverty trends in CSN



Status of poverty reduction

- Rural poverty in CSN is much higher
- Structural transformation and urbanization linkages

POVERTY BY LOCATION (NATIONAL LINES)



Rural Transformation is critical

- “Differences in the path and speed of structural transformation and rural transformation in APR lie mainly in the growth of productivity and the extent to which employment can be generated in the farm and non-farm sectors in rural and urban areas. Though initial conditions matter, **institutions, policies and investments are primary factors determining the path, speed and inclusiveness of rural transformation**” (IFAD, 2016)

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Policy Recommendations

The main question

- We are asking: What specific policy and institutional measures, by who (policy makers / international community) and in which (group of) countries (LDCs, LLDCs, SIDS, resource-rich, in systemic transition) should/could be introduced in terms of structural economic transformation to more effectively eradicate poverty in Asia-Pacific CSN;
- The threat: too broad approach and too generic policy recommendations.

The Chapter's proposed structure:

- (A) Macroeconomic Policies;
- (B) Industrial Policy;
- (C) The Role of the International Community (e.g. the UN system) and regional mechanisms (e.g. AEC, EAEU, BRI)

Industrial policy approaches

Functional policies:

- A more general and less interventionist approach that seeks to improve the business climate and promote competitiveness;
- For instance, property rights, access to credit, enabling infrastructure, labour market flexibility, etc.

Selective policies:

- A more interventionist stance with the state explicitly facilitating the growth of certain sectors (targeting);
- Such approaches typically attempt to defy a country's existing comparative advantage and harness its latent strengths by picking sectors that hold a potential;
- Given the coordination and information externalities involved such approaches are also more challenging, nevertheless, perhaps necessary.

Policies and strategies

Context Driven

- In the case of LDCs, there will be a need to enable faster growth in improving job-creating productive capacity building with a specific set of policies for selective investment in domestic industries;
- Resource-rich LLDCs may need to institute policies to improve natural resource management and leverage resources to promote inclusive economic growth in non-extractive sectors (diversification);
- SIDS, that are likely to face difficulty in setting up robust manufacturing sectors, will need to implement policies to focus on developing niches in some services such as eco-tourism, agro-tourism and adventure-tourism, where the labour intensity and spillover effects are perhaps higher than manufacturing would permit in such contexts;
- Enhancing productivity of the agriculture sector in addition to facilitating growth of the non-farm economy will be critical for poverty reduction initially.

Some additional preliminary observations

Taking into consideration specific features of Asia-Pacific CSNs:

- The targeting of industrial policy should go beyond traditional concept of comparative advantage;
- FDI attraction should be strategized – aligned with the long-term development strategy and aimed at enhancing the process of creation of productive employment;
- Mitigating of “primitivisation” of the industrial base is necessary;

Questions for discussion

- Is the traditional approach of ST is still a valid pathway for CSN?
 - How would the increasing pace of **technological advancement** (e.g. more tradable services, outsourcing, automation, etc.) shape the patterns of ST in CSN?
 - Would Lower trade costs and proliferation of GVCs versus protectionism
 - How the broader objectives of social inclusiveness and environmental sustainability in the SDG era
 - (domestic) Youth bulge and prospects for creating conditions for decent job opportunities