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How Can “Aid-for-trade” Transform LDCs?

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How Can “Aid-for-Trade” Transform LDCs?

1. Integration of LDCs into the global economy and the role of duty- and quota-free market access

1.1 Challenges and opportunities in a globalized world

Successive waves of trade liberalization have made the world market increasingly open. A multi-polar world economy is emerging, eliminating the need to rely on a limited number of export markets. Technological developments, allowing for faster and cheaper international communications, have made proximity to the market less important.

Although the world markets are open to least developed countries (LDCs), there are factors that make it more difficult for LDCs to compete, especially for manufactured products. The very rapid growth of output and productivity in a number of developing countries, possessing skilled workers and professionals, and where wages and production costs are still low, is difficult to emulate. In order to be internationally competitive, LDCs must, and can, find market niches, preferably at higher stages in the value chain.

Questions:

- 1.1.1 How does the emergence of highly competitive developing countries affect the trade prospects of LDCs?
- 1.1.2 Will regional and bilateral free trade agreements become more important than multilateral trade agreements under the WTO? If so, what are the implications for LDCs?

1.2 LDC integration into the global economy and duty-free market access

A combination of favourable commodity prices and improved macroeconomic management resulted in promising growth in LDCs between 2003 and 2007. Nevertheless, LDCs continue to be marginalized in world trade. A striking feature of LDC trade is the lack of export diversification. Except for a few LDCs, raw materials continue to dominate the export basket, and are the same as those exported for decades. Three primary commodities account for more than 75 per cent of the total value of LDC exports. The fact that FDI inflows into LDCs are predominantly focused on raw materials reinforces the dependence of these countries on primary commodities, creating an obstacle to the much-needed diversification of production and exports. The conditions for investment in industry must be improved to stimulate ventures in higher value-added activities.

For many years, LDCs have been demanding duty- and quota-free market access for their exports. There are numerous recent examples of developed and developing countries providing such access. Most preferential programmes, including EBA (Everything But Arms programme of the EU) and AGOA (African Growth and Opportunity Act of the US), have not been very effective. In some cases, the criteria for duty-free market access for an LDC product were difficult to meet. For instance, the rules of origin requirements for textile and apparel products are such that many businesses simply are either unable to fulfill the requirements or find the procedures too cumbersome and time consuming. Sometimes, the lack of predictability or certainty discouraged investment, particularly when the termination date of the preferential scheme was approaching. LDCs have continuously highlighted the need for rules of origin that are realistic, and asked for guarantees that preferential programmes would not be changed to their detriment.

Questions:

- 1.2.1 What are the major barriers to the LDCs' export diversification?
- 1.2.2 Why has trade liberalization in LDCs failed to generate dynamic growth and diversification of exports?
- 1.2.3 LDCs need to develop and exploit their natural resources for rapid economic development. FDI can help in this process. How can LDCs ensure that they export their natural resources in processed form and move up the value chain?
- 1.2.4 LDCs have considerable policy space and flexibility within the WTO rules. It is sometimes observed that they give up much of this policy space or flexibility in bilateral or regional agreements. Is there a need to pay attention to this aspect of trade regulations?

1.3 Operationalizing Aid-for-trade

The importance of trade in the economic development of LDCs is recognized, but existing programmes of assistance from donors were unable to increase the exports of LDCs as they failed to address the supply-side constraints. The Millennium Development Goal (MDG) 8, Target 13, addresses the special needs of the LDCs; and, MDG indicator 40 explicitly recommends that part of ODA should be earmarked for building trade capacity, to allow LDCs to reap greater dividends from the multilateral trading system and integrate into the global economy.

Throughout 2005-2006, stakeholders, including developed and developing countries, and multilateral institutions, worked together to create the framework and modalities for delivering Aid-for-trade. In October 2006, the WTO adopted a framework that is now being implemented.

Aid-for-trade has opened up new opportunities to ease supply-side constraints in trade-related infrastructure, such as transport and storage, communications, energy, and institutions. For optimal use of this development instrument, it is essential that the concept of recipient 'ownership' is firmly incorporated, and that donors and implementing agencies work in a coherent manner.

Questions:

- 1.3.1 How can Aid-for-trade be directed more towards developing products for export? How can SMEs benefit from Aid-for-trade?
- 1.3.2 In many LDCs, particularly for those that are land-locked or in sub-Saharan Africa, there may be a pronounced need to develop trade-related infrastructure and institutions in a regional context. How can Aid-for-trade be directed at addressing the needs of those countries?
- 1.3.3 How should the effectiveness of Aid-for-trade be judged? Can parameters to assess country-ownership and results-based management be developed?
- 1.3.4 LDCs are trying to mainstream trade into their development programmes. Is there a conflict in the allocation of resources for a trade-related project as against a social welfare project? How would allocation for trade projects be justified?
- 1.3.5 Do donors/multilateral agencies *also* need to mainstream trade in their policies and programmes for LDCs? In the absence of such mainstreaming by donors/multilateral agencies, can they increase their allocation for trade-related projects when there are competing demands from social sectors?

2. Productive capacity-building for economic transformation

Economic transformation of LDCs from agrarian, self-sustaining closed economies into modern, middle-income economies are goals shared by all. The process by which this can be achieved is not uniform. The target is to create wealth, enabling the country to develop rapidly.

1.3.1 The shift from agriculture to industry

Agriculture has not been the choice sector for generating wealth, as it is characterized by decreasing returns to scale and the output is dependent on the weather. The prices are beyond the control of the farmer, and fluctuate widely, and the producer is unable to respond to these price signals except with a long lag. Over time, there is a secular decline in the terms of trade between agricultural and industrial products.

Industry does not suffer from these disadvantages. Most industry allows for increasing returns to scale; as production increases, the cost per unit falls. Brisk technological development could allow for a rapid lowering of production costs, and the generation of wealth for the producer. Technological developments in one industry have spillover effects, leading to new products or processes elsewhere. Moreover, industry has much greater backward- and forward-linkage possibilities, than agriculture.

Agriculture also benefits from the development of industry. No country has ever become rich by producing and exporting foodstuffs alone, without the support of an industrial base.

Industrialization and technological change allow for the development of “synergies”. When the economy progresses, factors act together to produce cumulative causations. Institutions and processes respond to the increasing demands placed upon them.

Questions:

- 2.1.1 Is there any pre-condition that needs to be satisfied before moving to the manufacturing stage?
- 2.1.2 Is the shift to manufacturing recommended for all LDCs? How do you “pick” industries to support?
- 2.1.3 What is the role of “services”? Can services replace manufacturing? If so, when and where?

2.2 Role of markets and trade in economic transformation

With industrialization, and large-scale international trade, the need for the market increased manifold, and its character changed.

There seem to be stages that a country would pass through. The first stage is that of creating effective demand internally, or finding it abroad (such as, with the help of quotas or duty-free market access). Next, industries are established, when technology and innovation are critical. The industries, often regarded as inefficient when established, are protected with high tariff walls. This is also the stage of development of ports, airports, roads, power plants, etc. The third stage is that of looking for markets, taking advantage of economies of scale, and enhancing the competitiveness of industries. The final stage is that of free trade, when consumer welfare also comes to the forefront.

The sequencing of opening/globalization has to be carefully managed, depending on the stage of development of the industry or the nature of the industry itself. The timing of opening up of markets to the outside world is also crucial. Opening up too early will surely lead to deindustrialization, falling wages and social problems. To delay the opening too long will also have adverse consequences, and will seriously hamper growth prospects. It requires skill to find the cutting edge, but it is always better to err on the side of caution in opening up.

Questions:

- 2.2.1 Global markets can indeed provide effective demand. However, is it not increasingly more difficult for an LDC to meet the growing standards and requirements for entry into developed country markets?
- 2.2.2 How can Aid-for-Trade address the challenges developing countries face in meeting the quality and safety standards imposed by buyers, and in complying with the TBT/SPS agreements?
- 2.2.3 Competition forces firms to improve efficiency. At what stage should firms in LDCs be exposed to competition?
- 2.2.4 What are the indicators to suggest a move from protected to more open markets?

2.3 Driving force for economic transformation

The basic driving force of economic transformation is “entrepreneurship” in manufacturing, where increasing returns to scale is possible. Those who make profits by introducing new technology and process are vital for the economy. Without productive entrepreneurs, capital, labour and markets are sterile. Financial assistance without the means to absorb the capital productively, will only lead to further indebtedness. Investment in human capital without changes in the productive structures to create demand for skills required, will only produce emigration.

A successful strategy, to break the vicious cycle of poverty and underdevelopment, must address the productive structure. This implies increasing diversification away from sectors with diminishing returns (agriculture and raw materials) to sectors with increasing returns (technology, manufacturing, and services).

There does not appear to be any short cut to some stages of the learning process. Some historical stages may clearly be skipped: countries do not need to re-invent the steam engine; many may find it easier to leap into mobile telephony, without going through landlines. But taking a nation from the pastoral stage directly to a modern service industry may not be possible. The synergies from advanced manufacturing sectors may be needed.

Questions:

- 2.3.1 Is there any benefit from attracting sunset industries from industrialized countries to LDCs?
- 2.3.2 How does one create productive entrepreneurship?
- 2.3.3 Many LDCs see the share of services in their GDP growing, without going through the “manufacturing” stage. Is this an appropriate course of economic transformation?

2.4 Productive capacity-building

LDCs generally lack ability to ensure the competitive quality and quantity of tradable products, in conformity with international standards. Building capacities requires investment in physical and human resources, and in new technology. Clusters of manufacturing enterprises located in close proximity can increase productivity, through the sharing of know-how, specialized equipment and support services. Forward and backward linkages are also more easily created if a number of enterprises are located close to one another.

In many cases, success in exports requires integration of production and marketing activities into transnational value chains and business partnerships. The public sector provides essential services, as well as a stable institutional and macroeconomic environment in which the rules of the game are transparent and predictable.

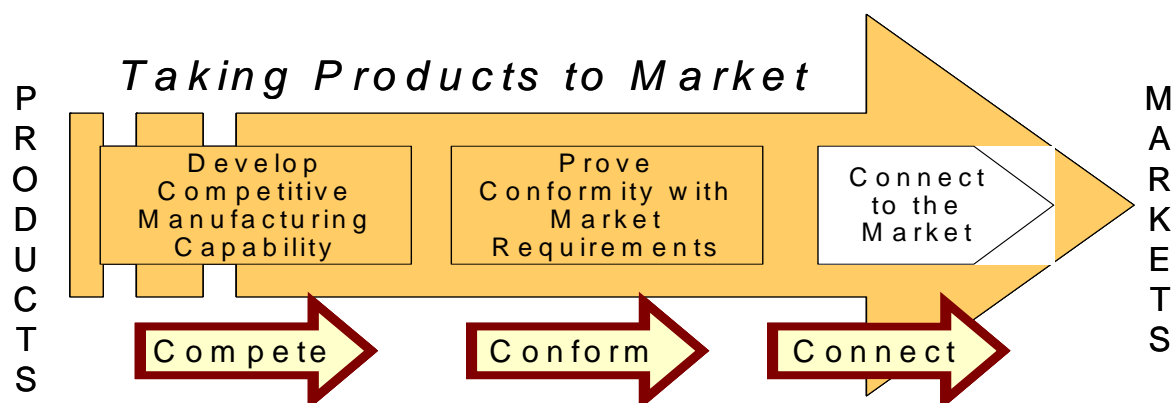
As the private sector is the main driving force of export growth, business associations in LDCs should play a more prominent role in the design and implementation of trade-related assistance.

Questions:

- 2.4.1 How can Aid-for-trade be used to improve the competitiveness of LDC manufacturers, and especially SMEs?
- 2.4.2 How can Aid-for-trade assist LDCs in developing tailored action plans for countries and sub-regions to build the physical and institutional (conformity, etc.) infrastructure for better integration into global markets?

2.5 UNIDO's approach to capacity-building: The three Cs

UNIDO has developed a strategic approach to trade capacity-building aimed at increasing exports of developing countries through action in three discrete but interlinked areas: *competitiveness, conformity, and connectivity*.



... by upgrading supply capacities and standards infrastructures

UNIDO programmes to develop *competitiveness* increase the capacities of countries to produce competitive goods. After identification of the goods with the greatest potential for local value addition and for exports, UNIDO offers services for upgrading the capability to international level.

Thereafter, UNIDO assists LDCs to *conform* to international standards, focusing on food hygiene and safety standards, by improving domestic laboratories and establishing adequate testing capacity. Finally, UNIDO helps *connect* with markets abroad, in cooperation with other agencies that may be required.

3. South-South cooperation in cotton

3.1 Market access and preference erosion

The elimination of the Multi-Fiber Arrangement (MFA) quotas has led to intensified competition, and a concentration of textile and readymade garment exports in fewer countries. LDCs also face increased competition in their domestic and regional markets. The benefits of preferential schemes for LDCs are gradually being eliminated with general trade liberalization.

For LDCs, the rules of origin requirements are a major obstacle to utilizing preferential market access; these are also different in major markets. The rules of origin for textiles and garments represent a complicated mix of processing criteria and value-added shares. Since most LDCs cannot produce all raw materials and intermediate inputs, they import them to produce the final product. However, many countries may be ineligible as source of the intermediates if the final product is to given duty free access. These restrictions have made it difficult or impossible to take full advantage of many preferences.

EU's decision to enforce the labelling of specific imported goods with the country of origin requires action on the part of LDCs. In textiles and clothing, origin labelling is complicated, in view of the many different countries that are often involved in the production chain. Somewhat different, but with similar consequences, are the demands for eco-labelling and fair-trade labelling required by many large importers and retailers.

Countries that have succeeded have done so by producing large volumes of products at competitive prices and in conformity with the high quality standards of major markets.

Questions:

- 3.1.1 Will intensified competition in the world market for cotton-based products necessitate a concentration of production in a smaller number of developing countries than at present?
- 3.1.2 Can Aid-for-trade be used to compensate LDCs for the preference erosion that has been taken place in the post-MFA era?
- 3.1.3 Can Aid-for-trade be used to help LDCs meet the new EU labelling requirements?

3.2. Position of LDCs in the global value chain in the cotton sector

The segmentation or disaggregation of production, enabling countries to specialize in a narrow task or product line, rather than having to produce the entire finished product, is helpful for LDCs attempting to find a niche in higher stages of the value chain.

The importance of moving up the value chain can be illustrated with a simple example: the value on the world market of cotton lint in a normal year, is in the order of US\$1 per kg; the figure for cotton yarn is US\$2.50/kg; for grey fabric US\$3.50/kg; for finished fabric US\$4.50/kg, and for garments US\$10/kg.

African LDCs account for nearly 13 per cent of global cotton exports, with China the most important market. Sub-Saharan Africa, as a whole, accounts for only 1 per cent of the total installed spinning capacity in the world. Total yarn exports from sub-Saharan Africa amount to only US\$10 million, and many cotton-producing countries have become net importers of yarn. Higher up the value chain, the situation is even worse. Only a few LDCs have been able to establish themselves as exporters of garments, but the competition is intense.

Questions:

- 3.2.1. How can Aid-for-trade be used to upgrade cotton-based industries in LDCs?
- 3.2.2. In the early stages of the value chain (such as, in spinning) the capital requirement is high, but the labour employed is low; on the other hand, at a later stage (such as, in garment manufacturing) considerable employment may be provided with little investment. Is there a trade-off between these choices?

3.3. The scope for enhancing intra-South value chain linkages in cotton processing and value addition

As a number of developing countries are important producers of raw cotton, while others are producers of textiles, and still others that of garments, the scope for South-South cooperation should be explored.

The upgrading of exports from raw cotton to yarn is the first step forward for cotton-producing LDCs. China, the world's largest importer of yarn, and other Asian countries are key markets. Spinning technology is uncomplicated compared with weaving and processing, bleaching, dyeing and printing. Conformity requirements on the world market are not particularly demanding.

New spinning equipment, with up-to-date technology for producing yarn, can be acquired from countries such as China and India, and installed in LDCs. Asian countries supplying new technology could also offer a market for LDC-produced yarn, as a first step for LDCs moving up the value chain.

Yarn is an input for the next stage: textile fabrics industry. The fabric industry is capital-intensive, and is poorly developed in most LDCs, in particular, in sub-Saharan Africa. This stage of the value chain may not be an option for all LDCs.

The final stage, production of garments, has the great advantage of being labour-intensive, providing gainful employment not least for women. Investment costs need not be prohibitively high for LDCs. The variety of products is enormous, and experience shows, innovative niche marketing approaches, such as ethical branding and the adoption of social codes of conduct, can be highly successful.

The garment stage requires special know-how. It is a strongly buyer-driven, involving production and marketing systems ranging from simple mass-produced products like T-shirts to products incorporating highly sophisticated modern design, research and development. Because fashion plays such a prominent role, the garments industry can be characterized as production of perishables. Advanced marketing and distribution systems, featuring modern management principles such as just-in-time delivery, are the key to success. This know-how is best acquired by linking up with foreign investors or buyers, many of whom are in Asia.

Questions:

- 3.3.1 How can LDCs attract investors from China, India and other countries with advanced technology and marketing skills in cotton-based industries?
- 3.3.2 Can regional and sub-regional organizations facilitate the establishment of textile clusters that enhance opportunities for economies of scale, as well as backward and forward linkages?

3.4 Technical and business exchange in the areas of cotton, textile and garments value chain

The garment sector is a promising sector for foreign investors seeking preferential market access granted to LDCs under the AGOA and EBA schemes. Research, transfer of technology and investment can play a crucial role and be mutually beneficial.

To facilitate technical and business exchange, a number of initiatives could be taken, such as:

- investment promotion meetings and business forums;
- rehabilitation of existing enterprises;
- SME entrepreneurship development, with examples from the South; and
- using South-South solidarity and mutual business interests to move up the value chain.

Questions

- 3.4.1 How policies would encourage countries to transfer part of their labour-intensive cotton-based industries to LDCs?
- 3.4.2 How can the SME sector be helped by foreign investors and business contacts?

3.5 Contours and tenets of a comprehensive action plan

The key to success is to establish an enabling business environment for the private sector.

For the first stage of the cotton value chain, which is the production of raw cotton, increased agricultural productivity is of paramount importance. It is also imperative to improve cotton quality, reduce contamination, including insects and associated quality problems, and ensure compliance with international standards.

In order to move to higher value added production, the short and medium-term objectives should be to strengthen the existing cotton value chain with a focus on developing competitive exports of cotton yarn in cotton-producing LDCs, as well as rehabilitating and upgrading other potentially viable segments of the existing value chain in selected LDCs.

The medium- and long-term objectives should be to move into other segments of the value chain, such as textile fabrics and garments, in selected niche areas, based on the availability of LDC-produced cotton yarn.

Questions:

- 3.5.1 How can Aid-for-trade, including technical assistance from specialized UN bodies such as UNIDO, contribute to a comprehensive action plan in the cotton sector?
- 3.5.2 What is the appropriate role of regional and sub-regional associations, such as ECOWAS and SADC, in the action plan?