

Statement by Dirk J. Bruinsma,
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Aid for Trade and the development of productive capacities

Ladies and Gentlemen:

Thank you for the opportunity to address this forum. I am very happy to be back in Doha, where five years ago the Doha Development Agenda was launched. Before beginning my remarks on Aid for Trade, I would also like to express my concern about the lack of tangible results to date from the Doha Round, and about the trend towards more bilateral agreements, which may leave some developing countries worse off. Let me now turn to Aid for Trade: UNCTAD considers this policy dialogue to be quite timely, since the direction of the Aid for Trade initiative is taking shape as we speak. It is therefore important to prioritize its activities, so as to maximize the long-term benefits of the initiative for recipient countries.

Rather than addressing the specific details of possible Aft country projects, I would like to present our views on how the overall initiative should be oriented and what some of its priority areas should be. One of the basic tenets of the initiative is to focus on supply capacities of beneficiary countries. Accordingly I will address the issue of development of productive capacities and how the Aft initiative can contribute.

As you may know, "development of productive capacities" is the subject of UNCTAD's *Least Developed Countries Report 2006*, which was launched last July. In this regard we are encouraged to see that six of the seven countries on which the OECD Development Centre has done studies are LDCs, while the seventh – Viet Nam – is frequently cited in our report as a model for LDCs to emulate.

My presentation has three parts. First, I will summarize the main findings and policy recommendations of the *Least Developed Countries Report 2006*. Second, I will show how they are relevant in contributing to shape the Aft initiative. Third, I will outline some relevant UNCTAD activities which in our experience have proved important for building productive and trade capacities and are relevant to the Aid for Trade initiative.

The central message of the report is that the development and utilization of domestic productive capacities – and the related expansion of productive employment – is key to ensuring the sustainability of both high economic growth and poverty reduction. They should therefore be placed at the heart of national and international efforts towards these goals.

What are productive capacities? Productive capacities are the productive resources, entrepreneurial capabilities and production linkages that together determine the ability of a country to produce goods and services and enable it to grow and develop.

Productive resources include natural resources, human resources, financial capital and physical capital. Production linkages refer to the exchange of goods, services and information between sectors and enterprises.

How do productive capacities develop? Three processes are involved: capital accumulation, technological progress and changes in the structure of the economy towards more modern and productive sectors. These processes drive the expansion of value-added and labour productivity within an economy and thus are vital for achieving sustained economic growth at levels sufficient to raise per capita incomes.

What does the successful development of productive capacities lead to? It brings about an expansion of value-added and increases in labour productivity of an economy, with the consequent effect of sustainable economic growth and poverty reduction. Let me recall that the latter are also the ultimate goals of the AfT initiative. There are various links between productive capacities and poverty reduction, but the creation of productive employment is the primary link.

Yet the process of development of productive capacities is not what has been taking place in the LDCs, as their economic growth rates show. Since their political independence, only seven of 40 LDCs for which data are available experienced steady growth: Bangladesh, Bhutan, Burkina Faso, Cape Verde, Lao PDR, Lesotho and Nepal. This means that rates of capital accumulation, technological progress and structural change remain insufficient in most of the LDCs. Why? There are three main constraints on the development of productive capacities in the LDCs:

- First, weak physical infrastructure, in terms of energy, transport, telecommunications, ports and so forth;
- Second, a weak domestic private sector and supporting domestic financial and knowledge systems. This means that these countries have a relatively undeveloped entrepreneurial sector (particularly small and medium enterprises), financial intermediation that is inadequate for financing productive investment, weak technological capabilities and only incipient development of national innovation systems;
- Third, demand constraints (mainly related to poverty), which mean that there are weak incentives for investment, technological learning and innovation.

But all is not bleak. The report finds that there are significant underutilized resources and capabilities within the LDCs. Underemployment and low-productivity labour are the clearest indications of this. But there is also untapped traditional knowledge, untapped natural resources, and latent entrepreneurship. And there are substantial possibilities for increased domestic financial resource mobilization, based on the increased monetization of the economy, the mobilization of surplus labour and a shift away from household to corporate financing of investments. Moreover, technological underdevelopment implies a major opportunity for fast technological catch-up through the acquisition and effective use of foreign technologies.

The question is then how to foster the development of productive capacities in LDCs and other low-income countries. There is a major opportunity – so long as the policies are right. These policies should seek to achieve increased employment of all existing productive resources, including labour, domestic financial savings and natural

resources, and to develop productive capacities by overcoming constraints on capital accumulation, technological progress and structural change.

Ladies and Gentlemen:

Let me turn now to the second part of my presentation, in which I will draw some policy implications from this analysis of relevance to the AfT initiative .

Developing productive capacities requires a paradigm shift in the current approach to national policies. National development and poverty reduction strategies need to focus on generating productive employment and overcoming constraints on productive capacity development – constraints that in turn hamper job creation.

I would like to look first at international policies, of which the AfT initiative is part. In order to make aid work for economic growth and poverty reduction, it is necessary to rebalance the sectoral composition of aid towards productive sectors, economic infrastructure and developing domestic financial and knowledge systems. The share of aid for in-country development programmes and direct support for programmes run by developing-country governments should also be increased. This refers in particular to the strengthening of infrastructure in those countries.

Let me illustrate why this is critical. In nominal terms, aid to the LDCs doubled between 1999 and 2004. In 2004, 46.5% of net ODA went to debt forgiveness grants, emergency aid, technical assistance and food aid. ODA to economic infrastructure and productive sectors declined from 48% of total aid commitments in 1992-1994 to just 24% in 2002-2004. (Consider, too, the fact that ODA commitments to banking and financial services accounted for only 1% of total aid commitments to LDCs in 2000-2003.) These trends should be stopped. The AfT initiative provides an opportunity to do so, at least partially.

I would like to recall that trade liberalization is not so much the issue as supply capacity. LDCs and other low-income countries have opened their trade regimes very rapidly over the last 15 years. They have also enjoyed preferential market access. Yet this has not resulted in a sustained growth in their export volumes or in a significant increase in the value added incorporated in their exports. Ultimately, the goods and services that these countries can supply competitively to world markets are limited by the goods and services that they can produce and how efficient they are at producing them. For them, supply-side constraints have been the greatest hurdles to taking advantage of preferential market access and increasing their share and earnings from international trade.

In fact, both the Report of the Task Force on the Enhancement of the Integrated Framework and the Report of the Task force on Aid for Trade place great emphasis on building supply capacities.

Supply-side capacity constraints reflect the overall underdevelopment of an economy and manifest themselves in various forms:

- Poor and inefficient infrastructure (i.e. roads, ports, utilities, telecommunications).

- Inadequate development of the banking/financial sector or supplier services sectors
- Inadequate regulatory environment (i.e. laws, regulations, agencies);
- Weak public-sector institutions (e.g. for education, training and technology support);

Tackling these supply capacity constraints requires capacity-building in a wide range of areas. With respect to trade, for example, there is a need to support trade policy formulation at the national level, and to support effective participation in the WTO (including in relation to accession) and bilateral and regional agreements. Complementary institution-building is also necessary, particularly the establishment of efficient procedures and institutions for import/export, insurance, payments, customs clearance and, for a number of landlocked countries, transit arrangements. There is further need to expand the transport network of roads, railways, air, sea and inland ports, and pipelines. While building hard infrastructure may entail major expenditure, building soft infrastructure such as policies, procedures and institutions can often be more difficult.

Ladies and Gentlemen:

Now for the third part of my presentation: a catalogue of some of the activities that we consider important for building productive and trade capacities and that are relevant to the AfT initiative. Although virtually all UNCTAD programmes deal directly or indirectly with trade and development and fall within the scope of the initiative, I would like to focus on three areas: investment promotion (domestic and foreign), entrepreneurship and enterprise development, and trade-related infrastructure and logistics.

First, building productive capacity depends on investments – by public authorities, and ultimately by private enterprises (domestic and foreign). UNCTAD Investment Policy Reviews of over 20 developing countries suggest that a pervasive impediment to private-sector investment is the set of general operating measures affecting all business, including FDI. There now appears to be general awareness and acceptance of this problem in most countries; one indicator is the high degree of government acceptance of the recommendations of our Investment Policy Reviews. In addition to assessing the policy environment for investors, including FDI, these reviews provide advice that goes beyond the simple including both policy recommendations and strategic suggestions for investment promotion and enhancement of the benefits from FDI. Besides stressing the improvement of the general regulatory framework, the recommendations highlight the importance of generating interactions with firms in related industries, technology institutes, universities and business development centres, among others. Suggested policy measures can be geared, for example, to facilitating cluster establishment, including setting up free trade zones, multi-facility economic zones, incubators and technology centres. In this context, any aid directed at building supply capacity for exporting must consider how to encourage further FDI in developing countries and how to foster linkages in order to build supply capacity.

The expansion of developing-country firms is hampered by numerous internal obstacles within firms themselves, including a lack of entrepreneurial and

management skills, limited access to and high cost of financing, the absence of business development support services, and difficulty in obtaining information on market opportunities. UNCTAD's analytical work on small and medium enterprises, linkages and export competitiveness suggests that improvements in capacity can be generated through targeted programmes to support SMEs and by linkages with networks of transnational corporations. One success story is UNCTAD's integrated capacity-building programme for entrepreneurship and enterprise development, EMPRETEC. Since 1988, this programme has enhanced individual entrepreneurial capabilities for over 80,000 entrepreneurs in 26 countries. In general terms, the programme identifies promising entrepreneurs; provides them with training to strengthen their entrepreneurial behaviour and business skills; assists them in accessing beneficial links with larger national and foreign companies; and sets up long-term support systems to facilitate the growth and internationalization of their ventures. For example, Enterprise Uganda is a hands-on programme based on the EMPRETEC model that was established in partnership by the government, UNCTAD and UNDP to support SMEs and promote linkages with TNCs through supply chain development.

Another area that deserves attention is that of trade-related infrastructure and logistics. The detrimental effects of poor infrastructure on production costs, transport costs, exports, poverty alleviation and development more generally are well documented. They are aggravated in the case of landlocked countries. Our analysis shows that on average, landlocked developing countries spend almost twice as high a proportion of their export earnings on transport (and insurance services) as that spent by developing countries in general, and three times as much as developed countries. In parts of Africa, it is more costly to trade goods with neighbours than with Europe. Improvements in soft infrastructure can be a cost-effective and speedy way to deal with some of these problems. For example, low-cost IT-based management systems developed by UNCTAD to facilitate trade and transport include our Automated System for Customs Data, or ASYCUDA, and our Advance Cargo Information System, or ACIS. The ASYCUDA programme is a computerized customs management system that is installed in more than 80 countries. It facilitates trade by modernizing and automating customs procedures. Information technology speeds up the process for the clearance of goods and helps simplify customs documentation. The computerization of customs tariffs, which automatically calculates duties and taxes, can also help increase government revenue and improve the reliability and timeliness of fiscal statistics.

Of course, if programmes to build local productive capacity are to have the maximum impact, national ownership is essential. The institutional structures of the AfT initiative should therefore allow for adequate needs assessment and participation of stakeholders in decision-making and programme design.

To sum up, building productive capacity touches on almost all areas of development policy and hence requires a multi-faceted approach to development assistance. AfT is an important way to jump-start the development process by creating a virtuous circle between trade and domestic productive capacity-building, and consequently economic growth, employment and poverty reduction in developing countries. This calls for using ODA more effectively to support proactive measures in areas such as physical

infrastructure, national financial systems, domestic entrepreneurship and trade logistics.

I can assure you that the UNCTAD secretariat is prepared to continue to assist its member States in the conceptualization, operationalization and implementation of the AFT initiative. As a "think tank" with a long history of intellectual contributions on trade and development, UNCTAD can assist in the conceptualization and design of the AfT programme. In addition, some of our technical cooperation activities, including those outlined above, can form an integral part of the operationalization.

UNCTAD is ready to cooperate with other development agencies, donors and developing countries in implementing this initiative. There is a need for greater coherence at the international level, particularly with regard to trade, investment and migration policies. The Aid for Trade initiative should be delivered in a transparent, accountable and effective way.

Thank you.

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