How the World Trading System Promotes and Impedes the Diversification of Developing Countries

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Abstract

Diversification is important because it is associated with economic growth and reduced volatility. Export diversification is especially important for developing countries as a source of foreign exchange and imported know-how. We examine how export diversification is affected by trade policies, including multilateral rules, regional trade agreements, and national measures. We argue that the world trading system is not presently supportive of export diversification in poor countries and, moreover, that the situation is deteriorating. There is much that the G20 can do to provide remedies.
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Policymakers usually think of export diversification as a shift from agriculture to manufacturing, but we adopt a broader and more literal perspective—that is, diversification of exports within sectors and across all sectors. We are interested in export diversification within agriculture and towards agriculture, within services and towards services, etc. Cadot and Carrere (2013) developed a useful decomposition of the widely used Theil diversification index. They separated diversification at the intensive margin (a more balanced export basket within existing products and markets) and diversification at the extensive margin (exports of new products and/or to new markets). Recent research has added a new aspect to measuring diversification, namely quality upgrading, which is reflected in higher export unit values (IMF, 2014). Our interest in these different facets of diversification stems from the fact that economic growth occurs across all sectors of the economy and it can take the form of improved quality (higher value added per unit as reflected in higher prices) as well as increased quantity. Defined this way, the broader based diversification is, the faster and more sustainable growth is likely to be.

Our key messages are:

• Diversification is associated with economic growth in the early stages of development. However, for policy purposes, it is misleading to view diversification as generating economic growth. Instead, it is best to think of diversification and growth as jointly determined by sound fundamentals, such as good governance.

• For most developing countries, especially lower-income countries, export diversification tends to reduce the volatility associated with exports of primary commodities.

• Today’s rich nations diversified initially from agriculture to manufacturing, but this traditional path is far less-prevalent today. This is because of increased international competition and trade barriers, which impede manufacturing exports. Moreover, manufacturing creates far fewer jobs than in the past because of automation. Diversification into manufacturing is still possible, of course, but in most instances, diversification nowadays entails progress more broadly across all sectors and within all sectors.

• Since diversification often entails the exploitation of specific niches in the product spectrum, SMEs can often play a crucial role in diversification. But they face many obstacles as they internationalize their activities.

• Foreign direct investment can, in the right circumstances, play a central role in promoting diversification, including through inclusion in global value chains.

• Though most developing countries would benefit from export diversification, the world trading system is far from supportive of diversification at present. Major barriers exist that prevent diversification towards and within agriculture, labor-intensive manufactures, and services. Disciplines in services and in investment are especially weak. Only in mining and minerals and in advanced manufactures (which are sectors out of reach for most developing countries) is trade relatively free.

• The world trading system is presently heading in the wrong direction—raising barriers to diversification rather than reducing them.
The G20 must break this trend and support a set of reforms that are especially critical to promote export diversification in developing countries. First, the rules-based trading system and the capacity to enforce the rules must be maintained. Second, tariff escalation and tariffs in labor-intensive manufactures must be reduced. Third, developing countries have unexploited diversification potential in agriculture which is severely impeded by subsidies, tariff barriers, and protectionist standards. Fourth, individual countries can take many steps to foster export diversification, the most important of which are improving the efficiency of their service sectors, liberalizing imports of services, and encouraging inward direct investment.

In the rest of this paper we briefly review the relevant literature and the record of the world’s developing regions on export diversification. We then examine the main trade policy impediments to diversification across and within agriculture, mining and minerals, manufacturing, and services. Before presenting our policy conclusions, we discuss the role of foreign investors, and of small and medium sized enterprises, in fostering export diversification.

Some Pointers on Diversification from the Economic Literature

Several studies have documented the links between export diversification, growth, and stability. The line of causality between diversification and stability has been clearly established (see IMF, 2014, for a useful summary). However, although many studies have shown a strong correlation between diversification and growth (for example, Gelb, 2012; Sachs and Warner, 1999), the line of causality between diversification and growth is far less clear (Brunnschweiller, 2008).

For policy purposes, it is best to view growth and diversification as jointly determined by fundamental drivers (including governance and institutional quality, trade openness, and efficient transport infrastructure). Diversification and economic growth are often mutually reinforcing but not necessarily directly causal in either direction.

Export diversification is not an end and is not always the right strategy. We often observe that it is possible to have economic growth without diversification. Simply stated, oil-dependent nations can grow by investing more in the oil sector. More generally, an important study showed that countries tend to diversify their exports at low levels of income but tend to specialize at high levels (Imbs and Warczia, 2003). Above a threshold, higher incomes tend to be associated with increased specialization as countries lose comparative advantage in labor-intensive product lines and rely increasingly on technology, product differentiation, and scale economies to compete.

As in the case of some centrally planned economies or economies that engaged heavily in import substitution, economic and export diversification that is induced artificially (e.g. using subsidies and protection) may not be supportive of sustained economic growth. Oil-rich countries (high oil endowment/population) have found it difficult to promote exports of manufactures without large-scale subsidization, creating many distortions and inefficiencies. Alternative paths for these nations are possible and likely to be more fruitful. They involve a combination of accumulation of assets abroad and promotion of vibrant domestic service sectors, i.e. asset and economic diversification, as distinct from export diversification. This approach can be entirely consistent with aiming for export diversification in the long run as the oil endowment declines.
Diversification and quality upgrading are path-dependent so that movement is easiest from one product/market to a slightly more complex and ‘nearby’ product/market (Hausman and Hidalgo, 2009). It is difficult to ‘jump’ into unrelated product markets, especially in weak investment environments.

As we discuss below, because of changed circumstances, namely increased competition and various trade barriers, diversification into manufacturing is more difficult today than in the past and many developing countries suffer from “premature deindustrialization” (Rodrik).

In summary, views on how to achieve diversification and promote growth and stability have varied widely. At least three competing intellectual traditions exist that argue for: a) import substitution and protection of infant industries (Prebisch, 1950; Singer, 1950); b) export orientation: a combination of protection of infant industries and active promotion of exports (World Bank, The East Asia Miracle); or c) free trade and integration into world markets (M. Wolf, Why Globalization Works), requiring inclusion in global value chains and diversification of imports to obtain access to the world-class services and parts and components, thus boosting productivity. In practice, countries nearly always adopt mixed policy approaches, including elements of protection, export support, access to imported inputs at low cost, and free markets, accompanied by a varying dose of regulation.

Within this mixed model, until quite recently, free trade within a rules-based system (little or no subsidization and many tariff lines at zero or near zero) had become the most frequently adopted approach in many countries, especially among the most advanced nations. That approach is now under serious challenge not only from poor countries, which demand more ‘policy space’, but also from China’s state-driven model, and the United States’ America First stance (Dadush, 2017).

The Diversification Record: 1960s to the present

In the post-war period, countries have generally succeeded in diversifying their exports. According to the most widely used diversification indicator, the Theil index, most economies were able to move to more varied export structures between the 1960s and 2014. The Theil index suffers from significant limitations, since it does not include services, for which detailed breakdowns and bilateral trade data is unavailable. The Theil index also fails to reflect changes in the quality of products, which can be in the direction of improved or reduced quality/unit values and higher or lower domestic value added.

Country experience varies greatly, but recent research using the Theil index suggests that much diversification has happened at the extensive rather than the intensive margin, as new geographic poles of demand have been created with the rise of China and the broader process of globalization. Nearly all countries saw increased diversification at the extensive margin, but only about one-third saw diversification at the intensive margin. More specifically, relatively few economies have achieved large-scale diversification into new products, but nearly all economies have achieved geographic diversification.

1. The Theil index was developed by the International Monetary Fund to measure the extent of diversification across a country’s exports. It can be decomposed into the extensive and intensive margins of diversification. The extensive export diversification reflects an increase in the number of exported products or trading partners, while the intensive export diversification considers the shares of export volumes across active products or trading partners. Higher values indicate lower diversification. The dataset was developed for 200 countries, but for many countries, the data coverage for the whole time range is not available. We thus calculate the average for the 1960s and the 2010s, and then measure diversification progress as the gap between the two averages, instead of calculating the gap between end points (1962 and 2014). For regional diversification index, they are available until 2010.
Advanced economies have the most diversified export structures and developing economies far less so. However, contrary to the broad-based diversification progress over time in developing economies, advanced economies tend to become more specialized as they shed product lines, such as shoes and garments, where they have lost comparative advantage (Cadot and Carrere (2013); Imbs and Warcziag, 2003). Figure 1 shows the Theil index for the exports of advanced economies. This index typically ranges from 2 to 8 across all countries, developed and developing, with the higher number indicating more specialization and less diversification.

**Figure 1: Advanced Countries, Diversification Performance**

![Figure 1: Advanced Countries, Diversification Performance](image)

The Theil diversification index can be usefully complemented with the International Monetary Fund’s (IMF) Export Quality Index, which allows an examination of the quality of exported products based on unit values. Figure 2 shows the change in the index for various economic regions starting in 1963 and continuing to 2010, the latest year for which the IMF calculated regional values for the index.

**Figure 2: Export Quality Index, Selected Regions, 1963-2010**

![Figure 2: Export Quality Index, Selected Regions, 1963-2010](image)

Source: IMF.
While advanced countries have seen high export quality over the whole period, other groups have seen considerable variation. The region that made the most progress over the years is Emerging and Developing Europe. Sub-Saharan Africa, in contrast, has seen a steady decline in export quality, while the Middle East and North Africa saw a decline starting in around 1994. Emerging and Developing Asia and Latin America and the Caribbean have remained at roughly the same level of export quality since the 1960s. Brazil, China, Russia, and South Africa were examined in the most recent data to 2014, which only includes individual country data. The export quality of these countries saw little change from 2010-2014.

Developing regions have seen vastly different trends in export diversification. We examine them from the least to the most successful in achieving export diversification.

**Sub-Saharan Africa**

Sub-Saharan Africa (SSA) was and still is the least diversified region. The lack of diversification has been associated with little progress in improving its tiny export share in world markets. It is, however, important to note that after a long period of stagnant growth, the mid-1990s saw the start of significant progress in diversification in SSA (Figure 3), and this was associated with significant economic growth, with average annual GDP growth of 4.8% from 1995 to 2010. Benefiting from a boom in commodity prices in the immediate pre-financial crisis period, sub-Saharan Africa grew at 6.3% a year between 2002 and 2008, faster than Asia.

**Figure 3: Diversification in Sub-Saharan Africa**

Diversification in Africa occurred predominantly at the extensive and geographic margin, driven by the rise of China and other Asian countries as major consumers of commodities. Thus, the diversification process in Africa is more an exogenous fact driven by a surge in demand for traditional exports than the result of domestic reforms that promote structural shifts towards more productive sectors (Rodrik and Macmillan, 2011). Nor was Africa upgrading the quality of its exports, as it remained trapped in exports of mining and minerals and agricultural products, where there is limited scope for quality upgrading. Indicators of quality upgrading (IMF, 2014) suggest that there was quality deterioration instead.
Unfortunately, but perhaps not surprisingly considering the previous discussion, as the world economy slowed, the region’s performance over the last decade has reverted partially to previous trends, with concentration in natural resources. The latest available data indicates that sub-Saharan Africa has recorded increased concentration. The value share of primary goods in total exports has remained unchanged at an extremely high level, 82%, and has increased in real terms, with energy and non-energy commodity prices in 2018 14% lower than in 2010. Africa’s manufacturing exports remain stagnant, in the vicinity of $60 billion, the level achieved in 2009, and are now about one-third the value of manufactured exports of Vietnam (Figure 4). Africa’s weak performance in terms of manufactured exports has not been compensated for by exports of services. Despite its high share in domestic value added, the African services sector contributes just 15% of total exports, compared to 22% for South-East Asia and 32% for South Asia.

Middle East and North Africa

The diversification trend in the Middle East and North Africa (MENA) is not encouraging. The region’s dependence on oil and gas, and other natural resources, has actually increased and the weight of natural resources rents in GDP doubled between the early 1970s and the first decade of the 2000s, accounting for 25% of GDP in 2010. As in sub-Saharan Africa, the diversification that has occurred reflects mainly a pattern of penetration of new markets around the world with traditional exports and does not reflect a profound economic transformation or much quality upgrading².

2. Unlike sub-Saharan Africa, the diversification issue in MENA is probably less urgent. Levels of GDP per capita are still among the highest in the world, and the region enjoys significant reserves of natural resources and sovereign funds able to hedge the economy at least in the medium term.
The main exceptions to this pattern are the resource-poor countries of Morocco, Jordan, Egypt, Tunisia, and Lebanon, where some export product diversification has occurred at both the intensive and extensive margins (Figure 5), most notably as resources have moved from agriculture to services. In contrast, in resource-rich countries, the decline in agriculture has been associated mainly with a surge in mining activities (World Bank, 2012). The exception is the United Arab Emirates, which has shifted from energy to services, some of which are knowledge intensive.

Figure 5: MENA region

<table>
<thead>
<tr>
<th>Diversification performance in MENA</th>
<th>Growth and rents in the MENA region</th>
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Source: IMF, WDI.

**Latin America and the Caribbean**

Latin America and the Caribbean (LAC) is more diversified than either SSA or MENA but has made only slightly better progress in recent years (Figure 6). In the early 1960s, LAC’s export concentration was similar to that of SSA and MENA, but then it moved ahead somewhat faster. However, as in the other two regions, export diversification has not been associated with a major shift towards higher-productivity sectors, and there has been a quality deterioration. There are exceptions to this general picture: Mexico, for example, is more diversified than the LAC average, having seen a sharp increase in exports and in export diversification in the 1980s after a large devaluation. Chile and Costa Rica, which are often cited as examples of diversification, have shown only a slightly faster rate of diversification than the LAC average, and have seen increased export concentration in recent years. However, Costa Rica has seen both significant changes in its export mix and quality improvement.
As in other regions, Latin America’s diversification and growth acceleration before the financial crisis came to an abrupt halt around 2014 as commodity prices fell dramatically, confirming the limited progress on domestic transformation.

**Asia**

Most Asian developing economies have experienced both rapid export diversification and structural shifts towards manufacturing and some higher-productivity services, reflected in high economic growth over long periods (Figure 7). Asia’s diversification has occurred both at the intensive and extensive margins, involving new products and new markets, and has also entailed significant quality upgrading. The South-East Asia region diversified faster than any region from 1962 to 2010. China followed a similar path. Over this period, developing Asia went through a remarkable structural shift as agricultural employment shrunk, while employment in services and to a lesser extent manufacturing increased sharply. Reflecting it more diversified and productive resource base, and despite the global slowdown in the wake of the global financial crisis, and also despite the secular deceleration of China’s economy, Asian growth rates have held up quite well in recent years.
Figure 7: Diversification in Asia

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<th>Diversification index in Asia</th>
<th>Diversification in China, Japan, and Korea</th>
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<td><img src="image" alt="Graph showing diversification index in Asia and China, Japan, and Korea" /></td>
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Source: IMF.

Eastern Europe

The fall of the Berlin Wall marked a major turning point that was followed by extremely rapid structural transformation and diversification of the economies of Eastern Europe, where the level of export diversification is now comparable to that of advanced countries (Figure 8). In 2020, countries including Poland, Latvia and Serbia had export structures among the most diversified in the world. Although diversification occurred at the intensive margin, it was even more important at the extensive margin, and entailed both new products and new markets as the Eastern European economies became integrated with the European Union.

Figure 8: Diversification in Eastern Europe

<table>
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<th>Diversification index</th>
<th>Diversification index in Eastern Europe, extensive margins</th>
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<tr>
<td><img src="image" alt="Graph showing diversification index in Eastern Europe" /></td>
<td><img src="image" alt="Graph showing diversification index in Eastern Europe, extensive margins" /></td>
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Source: IMF.
The remarkable progress on export diversification in Eastern Europe illustrates the efficacy of far-reaching domestic market and institutional reforms (a condition of accession to the European Union), combined with open markets (capital, labor, goods, and services) and large amounts of aid (EU Structural Funds).

**Trade Policy Impediments to Diversification**

In this section, we review the trade policy impediments to diversification as they affect agriculture, manufacturing, services, and mining and minerals.

The post-war period has, until very recently, been characterized by increasingly open markets and increased economic integration at global and regional levels. A historic acceleration occurred in the late 1980s and early 1990s with market reforms in China, the collapse of the Soviet Union and the shift from regulated and closed economies to liberal and trade-friendly ones, as exemplified by the institutionalization of the General Agreement on Tariffs and Trade (GATT) system and the creation of the WTO in Marrakesh at the end of 1994.

As shown in recent editions of Global Trade Alert, trade policy impediments have increased in recent years, most notably because of the trade war between China and the United States. Although the effect of these restrictions may not yet have affected the poorest countries in a major way, the deterioration in the trading climate, which includes a direct challenge by the United States to the operation of the WTO dispute settlement system, is highly likely to strengthen the hand of protectionist interests around the world.

**Agriculture**

Agricultural trade patterns have evolved significantly since the start of the century. Between 2000 and 2016, global agriculture trade more than tripled in value, rising to $1.6 trillion from $570 billion (FAO, 2018). Two trends are also notable: the increasing importance of emerging economies in agricultural markets—including the rise in South-South agricultural trade—and the development of global value chains (GVCs) in the agriculture and food sector (FAO, 2018; OECD, 2020). The role of agricultural trade will likely increase because of rising demand, changing diets, and increased variability in production flows associated with climate change.

The potential for agriculture trade to drive diversification of export products and markets, increased value addition, and higher productivity jobs is significant. While access to infrastructure, skills, finance, and other enablers is indispensable for agricultural transformation to succeed (Brenton et al, 2019; Said and Vencatchellum, 2018), trade policy is critical to provide more open and secure access to global and regional markets, and to improve competitiveness in the agri-food sector.

The 1995 WTO Agreement on Agriculture (AoA) brought substantial discipline to agricultural trade with new rules on market access, domestic support, and export competition (Glauber, 2019). Since then, however, progress in multilateral agricultural negotiations has proven elusive, with the significant exception of the 2015 WTO Ministerial decision to phase-out export subsidies (the Nairobi decision) and the 2014 Trade Facilitation Agreement, which, while not specific to agriculture, positively impacts trade in perishable goods by reducing time to export and import (WTO, 2015). At the bilateral and
regional levels, since the mid-2000s preferential trade agreements have supported greater integration of agricultural markets via tariff elimination across products (Thompson-Lipponen and Greenville, 2019). They have also contributed to reduced non-tariff barriers, regulatory harmonization, and trade facilitation. In addition, unilateral tariff reductions have opened agricultural markets in some countries, including through non-reciprocal trade initiatives (Bureau et al, 2017).

Despite progress, agriculture trade integration continues to be constrained by multiple and opaque border barriers, and by distortive domestic support across regions; moreover, agricultural trade liberalization in some major economies has not only stalled but protectionism is on the rise (OECD, 2019). More recently, trade confrontations have resulted in higher trade costs and trade policy uncertainty (World Bank, 2020), with the agricultural sector particularly hit (Chinn and Plumley, 2020).

Barriers to agriculture trade take different forms and impact both access to foreign markets and domestic firms’ export competitiveness. Even when tariffs have been reduced, applied tariffs on agricultural products are still some three times higher than applied tariffs on all goods (Figure 9). Certain products, including dairy and sugar, attract higher barriers in many countries. Tariff escalation continues to restrict processing of raw materials and hence product diversification and value addition. High tariffs and other barriers also limit producers’ access to seeds, fertilizers, and other inputs, reducing opportunities for competitive diversification.

**Figure 9: Average ad valorem equivalent of import duties applied to imports, and duties faced on exports, for all products and for agricultural products, by region, 2016**

![Average ad valorem equivalent of import duties applied to imports, and duties faced on exports, for all products and for agricultural products, by region, 2016](Image)

Source: Bouet and Odjo (2019).

While farm support in some developed countries has been reduced, total support remains high and concentrated in specific commodities. In larger emerging markets, as incomes have grown, agricultural domestic support has grown as well. Total support provided to farmers in OECD countries plus China, India, and 10 other key emerging countries, amounted to $528 billion per year from 2016 to 2018 (OECD, 2019). According to OECD data, support is highest in China, the European Union, the United States, and Japan (Figure 10).
Figure 10: Producer support estimate for selected G20 countries and the European Union in $, 2018 (*)

Source: OECD (2019a). Note: (*) Argentina provides negative support to its agricultural sector mainly due to export taxes that depress domestic producer prices. The negative value of the Producer Support Estimate in India means that domestic producers are implicitly taxed, as budgetary payments to farmers do not offset the price-depressing effect of complex domestic regulations and trade policy measures, which often lead to producer prices below comparable international market levels. Information is not available for Indonesia and Saudi Arabia.

Meanwhile, policy reforms have largely stagnated over the past decade, with some countries arguably moving backwards (Glauber, 2019). As almost two-thirds of producer support in 2015-2017 was provided via measures that strongly distort production and trade, these measures effectively tax domestic downstream agri-food sectors, reducing domestic value added in agri-food exports (OECD, 2019).

In the case of export subsidies, the AoA has delivered significant reductions, facilitated by higher commodity prices between 2000 and 2008 (FAO, 2018). The Nairobi decision resulted in complementary disciplines on export credits, food aid, and agricultural exporting state-trading enterprises. Little progress has been made, however, in disciplining export restrictions, which have been proven to exacerbate world price volatility in times of crisis (Glauber, 2019).

Sanitary and phytosanitary measures and technical measures play a critical role to ensure food safety and other legitimate objectives; they may also support increased export competitiveness. However, standards may also be used as non-tariff measures (NTBs) to favor domestic producers or to discriminate against certain exports (Zahniser et al, 2018). Even when not intended to restrict trade, the time and cost of compliance can limit access to markets, and failure to meet standards may exclude firms from...
GVC participation. Other NTBs such as seasonal import bans or quotas, limit the scope for participating in regional agricultural value chains, an important driver for export diversification (World Bank, 2020).

High costs of exporting and importing, based on border and documentary compliance, also limit the potential for agri-food diversification and integration into value chains, as does the slow and unpredictable movement of products, with perishable goods and small traders particularly impacted. Restrictions to trade in services in markets of origin and destination alike can hinder logistics performance, transport connectivity, and distribution services, further increasing trade costs (World Bank, 2020). Services trade barriers may also raise energy, telecommunications, and finance costs, further eroding firms’ competitiveness and their ability to diversify (Brenton, 2019).

Digital technologies present new opportunities for streamlining a hugely complex food system and reducing transaction costs. They can also help create new sources of value in the agri-food chain via the ‘datafication’ of agriculture, which allows assets and production processes to be monitored, tracked, analyzed, and optimized (Jouanjean, 2019). A restrictive trade policy framework, however, may limit the potential to leverage the access and use of data to increase transparency, efficiency, and resilience of the food value chain through measures including improved traceability, facilitation of standards compliance, and supply chain management and border processing.

While countries can act unilaterally to improve their agri-food export competitiveness, international economic cooperation is needed to reignite rulemaking and trade liberalization in support of agriculture trade diversification and participation in value chains.

Manufacturing

A roadblock in the path of the development of lower income countries is “premature deindustrialization”, meaning that the share of the manufacturing sector in employment (and sometimes in GDP) declines at a much lower level of income than seen historically in advanced countries. Dani Rodrik, the leading exponent of this phenomenon has written: “since 1990 countries have reached peak manufacturing employment at incomes that are around a third of the levels experienced before 1990” (Rodrik, 2016). This is an issue because industrialization is strongly associated with diversification of the export base and has been tied to rapid convergence with the productivity level of manufacturing in advanced countries.

Premature deindustrialization is also an issue because manufacturing remains, contrary to the impression of many in advanced countries, a rapid growth sector at the global level. Manufacturing value added has grown rapidly since 2000, at least matching world GDP growth, even after the global financial crisis. The rapid growth reflects mainly rising demand for manufactures, especially in developing countries. However, because manufacturing has become increasingly automated, manufacturing employment has increased at only a slow pace, both before and since the global financial crisis. Manufacturing employment growth has provided only about 10% of the new jobs needed to compensate for losses in agriculture and the growth of the active population (Ait Ali and Dadush, 2019).

Most important for our purposes, manufacturing accounts for the bulk of world trade in gross terms (although far less in value added terms). As Figure 11 shows, in 2017, global exports of manufactures amounted to $12 trillion. Manufacturing exports have grown rapidly since 2000, at a rate of 5.9%, but slowed sharply after the outbreak of the financial crisis.
Figure 11: World Manufactures Exports, 2000-2017

Tariffs are today a fraction of what they were in the early post-war period, and trade is freer. However, major trade policy obstacles still lie in the path of low-income countries attempting to diversify their export bases into manufacturing. In addition to the sharp slowdown in world trade in manufactures in the wake of the financial crisis, we can point to three other phenomena: increased competition in the most labor-intensive sectors (which are the traditional sources of comparative advantage in poor countries); a global tariff structure that penalizes those sectors; and various forms of non-tariff barriers. Only the last two are trade policy impediments, but the first obstacle, which ironically is one result of freer trade, is crucial for understanding the present difficulties.

(i) Increased Competition

The global manufactures market has been transformed over the last quarter-century. As central planning and import substitution gave way to market-oriented policies, a large number of emerging nations, beginning with China, have become major players in low- and mid-range manufactures, and are increasingly moving up the value added chain (quality upgrading). As Figure 12 shows, the world’s richest countries (fifth quintile of countries ranked by PPP income per capita) have seen their share of manufactures exports decline sharply, while that of middle income economies (third quintile) has surged from low levels. Meanwhile the poorest countries, which are home to 600 million people, saw their share slide from a minuscule level in 1994 to close to zero, (0.1%) in 2017.
Figure 12: Manufacturing Export Market Shares

![Manufacturing Export Market Share by GDP/Capita Quintile](image)

Source: WITS.

Over this period, the market share of the richest quintile of countries fell from 80% of the global market to 60%. These losses occurred across most advanced countries, with Japan and the United States taking the biggest hits. The upsurge in the third quintile is predominantly accounted for by China, which saw an increase of 14 percentage points in its manufacturing exports market share between 1994 and 2017. Other middle-income countries including India, Lithuania, Mexico, and Poland saw more modest, but still significant gains, each growing their market share by about one percentage point. Other countries in this bracket, such as Brazil and Malaysia, saw significant drops in market share.

Among the lowest quintile of countries only a few saw a significant increase in manufactures exports, such as Uganda, Togo, Madagascar, and Mozambique, while most other countries saw little change or a decline from low levels. The poorest countries, which a quarter century ago could aspire to diversify into sectors such as garments dominated by countries where wages were a multiple of theirs, now must contend with China, India, Mexico, Bangladesh, and Vietnam for the same.

(ii) A tariff structure biased against diversification

The present global structure of tariffs is biased against diversification into manufactures and within manufactures in three main ways: there has been tariff escalation; the highest tariffs are in the sectors that are potentially of greatest interest to poor countries; and developing countries, which represent the fastest growing segment of world imports, have the highest tariffs.

As Figure 13 shows, MFN tariffs on consumer goods are about 6%-8% higher than tariffs on imported inputs (intermediates, raw materials, capital goods). Since imported inputs account for a large share of the price of consumer goods, this means that the effective rate of protection on consumer goods may be twice that of nominal protection. The present tariff structure thus forces poor countries to concentrate on raw materials, or to try and break into the market for intermediates and capital goods, even though they may not have the scale or experience to do so. For the world’s poorest countries (e.g. the Least Developed Countries as defined by the United Nations), the tariff escalation problem
is alleviated by various multilateral and regional preferential schemes, reflected in the lower AHS (effectively applied tariffs) in Figure 13. However, these schemes often bring with them onerous rules of origin requirements and other conditions that are difficult to fulfill.

**Figure 13: Applied Versus Effective Tariffs**

![Graph of Applied vs Effective Tariffs by Product Group](image)

Source: WITS.

Diversification into large export sectors such as garments is of potentially greatest interest to the poorest countries, and transportation is of potentially greatest interest to middle-income countries. But as Figure 14 shows these are also the manufacturing sectors with the highest tariffs (tariffs on food products are higher still). Moreover, as shown in Figures 15 and 16, which rank the G20 countries by income per capita (from left to right), the highest tariffs are in the developing members of the G20. Since these countries now represent a large share of world trade and are the fastest growing, it is evident that diversification is impeded increasingly by trade policies in developing countries, and not in advanced countries.

**Figure 14: Applied vs Effective Tariffs by Product Group**

![Graph of Applied vs Effective Tariffs by Product Group](image)

Source: WITS.
(iii) Non-Tariff Barriers

Beyond tariffs, exporters in developing countries face many regulations and restrictions on their products that can hamper their efforts to diversify. Although these regulations can be used as a means of protection, and often are, most measures, such as sanitary standards or other consumer safety regulations, are necessary to fulfill domestic policy objectives. Still, the cost of compliance and the organizational skills required often lie beyond the capacity of all but the largest firms in developing countries. For example, the European Union and the United States, which together account for a large share of world imports, employ arrays of import regulations that exceed that of most developing...
countries and the world average. Thus, the measures employed by the United States cover 77% of incoming products while those of the European Union cover over 94%. The coverage rate for lower-income countries is around 55%. The measures leveled by the two giant advanced economies are similar in composition, with both making heavy use of labeling requirements, and product testing and quality control standards, but the EU places more emphasis on certification and inspections than does the United States.

Figure 17: NTB Coverage by G20 Member

![Graph showing NTB Coverage by G20 Member](source: WITS)

Among the sectors most affected by non-tariff barriers are textiles and clothing, and to a lesser degree, transportation (Figure 18).

Figure 18: NTB Coverage by Sector

![Graph showing NTB Coverage by Sector](source: WITS)

Daunting as this list of impediments to diversification in manufacturing is for poor countries, it is not complete. For example, industrial subsidies, difficult to identify and police, are still widely used, even though they are illegal under the WTO and are frequently the subject of WTO disputes.
The poorest countries do not have the fiscal capacity to counterbalance these subsidies. Rules on the protection of intellectual property, while economically justifiable to encourage innovation, can be overly restrictive, and can deter poor countries from adopting the best technologies or entering new markets. The proliferation of patents and trademarks, some of them spurious, adds to the obstacles faced by the less equipped.

**Services**

In the past, services did not play a key role in debates about strategies for export diversification. This reflected the fact that most services were considered ‘non-tradables’ and their relevance for trade performance was often characterized as marginal at best. This characterization, however, was not accurate. Transportation and travel, for example, have always been important components of international trade. Moreover, since the early 1980s, international services transactions have expanded rapidly as new modes of supply have materialized, including services transmitted over electronic networks³.

Services promote export diversification on several levels. First, trade in commercial services (transport, travel, and other services, including brokerage, insurance, communications, software, professional services, royalties, and income generated by temporary labor movement) has been growing at a faster pace than merchandise trade in the post-financial crisis era. While trade in goods has expanded on average at 1% per year since 2011, the value of trade in commercial services has grown at 3% per year over the same period⁴. This expansion reflects not only the growing importance of trade in the context of global value chains (which now account for roughly two-thirds of global trade) and fragmented global production, but also structural economic transformation.

Developing economies—excluding LDCs—have substantially increased their participation in trade in commercial services: their participation in exports increased from 14.7% (2005) to 25.2% (2017); and from 23.0% (2005) to 34.4% (2017) in the case of imports of commercial services⁵. China and India have been major players in this process. This channel for export diversification is driven by the evolving business model of globalization and the structural growth of the services sector in developing economies. In the case of LDCs, services exports have also been growing rapidly (almost 11% per year since 2005) with international tourism being the main driver.

The second channel through which services support export diversification reflects the role of technology in the context of delivery of cross-border services transactions. Information and communication technologies (ICT) have significantly expanded the tradability of services. ICT-enabled services include financial and insurance services, telecommunications, computer and information services, business services and personal, cultural, and recreational services. Global exports of these services more than doubled between 2005 and 2017, reaching more than $2.3 trillion. It is also worth mentioning that some developing countries (e.g. India) have become major exporters of ICT services via the deployment of professionals abroad.

Another important channel for export diversification has been the role played by services via a commercial presence abroad. Service transactions associated with commercial presence accounted

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³. See, for example, Hoekman and Primo Braga (1997).
⁴. Most of the data on trade in services reported in this section is based on WTO (2019).
⁵. These estimates encompass services transactions via all modes of delivery, including commercial presence (Mode 3). See WTO (2019).
for roughly 59% of global trade in services, underscoring the importance of foreign direct investment policies in promoting services trade. It is worth noting that the services sector has become the main destination for FDI flows around the globe. Although firms from developed economies are responsible for most of these service transactions, one can also observe a growing participation of companies from Brazil, China, and India.

There is, however, another channel through which services play a critical role in the process of economic diversification. All over the world, but particularly in developed economies, one observes the growing ‘servicification’ of manufacturing activities, as services inputs embodied in the production process (e.g. R&D, design, and professional services), and services activities at the point of sale (e.g. financing, training, marketing, after-sales support), become increasingly important in terms of value-added. From a policy point of view, these trends underscore the importance of focusing on value-added data rather than gross value data. For OECD countries, for instance, services account for roughly 50% of value added in exports, including indirect exports of services provided to manufacturers. As often noted among firms in the computer industry in California’s Silicon Valley, “70% of hardware is software” (Loungani and Mishra, 2014). And it is estimated that up to 40% of the value of modern electric cars is related to services and software (Cernat, 2019).

Policy barriers to trade in services are mainly regulatory in nature and tend to be more complex than barriers to trade in goods. Although there has been progress in terms of services trade liberalization over the years, certain sectors (e.g. professional services) remain characterized by high levels of protection even in OECD countries.

Restrictions on foreign entry, the movement of people, and competition, as well as regulatory complexity, are the main barriers to trade in services. Their impact varies across sectors, but typically these barriers are quite significant with respect to transport, professional services, and broadcasting. Restrictions on foreign entry are pervasive in transport sectors, broadcasting, and telecommunications. Restrictions on the movement of people, in turn, are significant for legal and accounting services, and for infrastructure services (construction, engineering, and architecture services). Recent policy changes (2019) have on average increased the level of trade restrictiveness across most service sectors. Barriers to computer and audio-visual services have also increased (OECD, 2020).

It is important to underscore that trade liberalization can be a major lever for diversification. This can be accomplished unilaterally, as illustrated by the experience of Chile with respect to its transportation sector. Chile maintained flag discrimination and cargo preferences until the late 1970s. Liberalization of these policies had a major impact on costs for shippers and fostered exports of new products, including fruits and fish.

The General Agreement on Trade in Services (GATS) provides a platform for multilateral trade liberalization. Unfortunately, however, if one analyzes the liberalization impact of commitments made in the context of the Uruguay Round (1986-1994) the results have been modest to say the least. Most countries have made limited commitments in terms of sectoral coverage and often these commitments have not improved upon status-quo policies. Since then, although some advances have occurred at multilateral level in sectors such as basic telecommunications and financial services, progress remains limited. And the impasse in the Doha Round negotiations does not provide much hope for the multilateral track at this stage.
One has witnessed, however, the proliferation of regional trade agreements (RTAs), many of which nowadays include GATS+ provisions with respect to services liberalization. These RTAs have made progress in promoting regulatory coherence between trading partners and improving transparency but promoting services trade reforms via trade agreements remains difficult.

It is important to recognize that the trend towards the growing importance of the services sector in the world economy is now entering a new phase. Throughout modern history, one can identify waves of innovation that marked the beginning of a new era. These waves are typically associated with so-called general-purpose technologies (GPTs), which have had dramatic implications for wealth creation, income distribution, jobs, and wages. The steam engine (the impetus for the first Industrial Revolution, 1760-1830), electrification (the trigger for the second Industrial Revolution, 1870-1914), and ICT (the trigger for the current digital age) had significant impacts on productivity, international trade, and the economic structure of nations. The next wave of GPTs is centered around artificial intelligence (AI) technologies.

It is difficult at this stage to estimate the impact that AI will have on the labor market. This GPT, however, will affect both manual labor and more knowledge-based activities. The productivity impacts may be significant, but these innovations will tend also to foster income inequality and job displacement. To address these challenges, it will be fundamental to invest in retraining the workforce with a view to explore new partnerships between humans and AI-based innovations. Such a strategy is inevitably services-intensive and requires a rethinking of how education systems will adapt to this new world.

It is worth underscoring that one factor is found consistently to have an impact both at the extensive and intensive margins of export diversification. This is human capital, particularly as captured by basic education. In short, educational services are at the very core of the process of economic diversification.

**Mining and Minerals**

Geology determines the depth and extent of each country’s mining and mineral sector, and no country is self-sufficient in all raw materials. Metals and minerals are vital inputs and are processed in large quantities in sectors ranging from power generation to manufacturing of automobiles, airplanes, and machines. Additionally, new technologies have increased demand that uses raw products, such as rare earths, which have specific characteristics that are difficult to substitute. Although tariff and non-tariff barriers on imported raw materials tend to be lower than in finished and intermediate products, various restrictions on trade in mining and mineral products, including export taxes, are disruptive to global supply chains and impede countries’ ability to diversify their economies in various ways.

For example, the average MFN tariff on raw materials is about 6% but can be much higher depending on the commodity. Taxes on raw materials increase the cost of products early in the supply chain, as raw products are transformed into semi-processed goods and traded to be used in the production of final goods (Chatham House, 2014). Restrictions not only impact costs but also introduce the element of uncertainty (Fung and Korinek, 2013). Developing countries that impose high tariffs and taxes on raw material imports reduce the likelihood that the downstream sectors, manufacturing of intermediate and finished goods, can compete successfully on export markets or against imports at home.
High tariffs on imported raw materials also deter exploration. It is a matter of global interest to find them and exploit undiscovered mineral endowments. The mining and minerals sector is capital intensive and requires an efficient and affordable logistics chain to take the product to market. Tariffs and taxes deter these investments, as does uncertainty associated with the regulatory regime.

Import tariffs and export taxes are treated differently under WTO law. In the wake of several rounds of GATT/WTO negotiations, applied import tariffs have been cut, and ceilings have been agreed in many instances. However, export taxes are not subject to such disciplines and are applied for many reasons, ranging from revenue, containing prices for domestic consumers, to countering tariff escalation in trading partners. According to the World Bank, 55 countries impose 277 non-tariff measures on exports of metals and minerals (Table1).

### Table 1

<table>
<thead>
<tr>
<th>Tariff Measures on Exports</th>
<th>Imposed NTM</th>
<th>Metals</th>
<th>Minerals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Export related measures</td>
<td>84</td>
<td>43</td>
<td>41</td>
</tr>
<tr>
<td>Licensing or permit requirements to export</td>
<td>50</td>
<td>27</td>
<td>23</td>
</tr>
<tr>
<td>Export technical measures, n.e.s.</td>
<td>28</td>
<td>11</td>
<td>17</td>
</tr>
<tr>
<td>Certification required by the exporting country</td>
<td>12</td>
<td>4</td>
<td>8</td>
</tr>
<tr>
<td>Export Registration requirements</td>
<td>18</td>
<td>10</td>
<td>8</td>
</tr>
<tr>
<td>Export taxes and charges</td>
<td>21</td>
<td>8</td>
<td>13</td>
</tr>
<tr>
<td>Export Prohibition</td>
<td>20</td>
<td>12</td>
<td>8</td>
</tr>
<tr>
<td>Export measures n.e.s.</td>
<td>13</td>
<td>7</td>
<td>6</td>
</tr>
<tr>
<td>Export quotas</td>
<td>12</td>
<td>7</td>
<td>5</td>
</tr>
<tr>
<td>Measures on Re-Export</td>
<td>4</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>State trading enterprises, for exporting</td>
<td>5</td>
<td>3</td>
<td>2</td>
</tr>
<tr>
<td>Export subsidies</td>
<td>3</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Export quantitative restrictions, n.e.s.</td>
<td>3</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Export price control measures</td>
<td>3</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Export technical measures</td>
<td>1</td>
<td>0</td>
<td>1</td>
</tr>
</tbody>
</table>

Source: World Bank WITS Database

Export quotas are not allowed by the WTO, but countries use a variety of restrictions—such as licenses—that can have the same effect. Export restrictions are widely used, especially by developing countries, but not only by them. Thus, a recent WTO analysis identified 841 export restrictions of various types, including export taxes, imposed by China from 2000 to 2012, 693 imposed by Argentina, and 308 imposed by India. These three G20 countries are the most active users of export restrictions.

Export restrictions in the raw materials sector are sometimes motivated by the desire to promote export diversification into related higher value-added activities. The aim is to promote a cluster, including raw materials, services, logistics, intermediate goods processing, and end-product manufacturing. Examples would be cocoa to chocolate clusters, or petroleum to gasoline clusters.
However, export restrictions are unlikely to be the best policy instruments to promote downstream diversification (OECD, 2014).

Chile, the world-leading copper producer, and exporter is recognized globally for its competent governance (OECD, 2014) of the sector, which has helped support a modest degree of diversification into mining services. Chile’s tax system for the mining sector is predictable and balanced. A corporate income tax of 20% applies to all firms in Chile. However, firms can accelerate depreciation deductions, which is particularly important for the mining industry, and small firms are treated more favorably (OECD, 2014). Chilean firms have positioned themselves as experts in mining technology and management and have exported their services globally.

The Role of FDI in Diversification

FDI is important for diversification across the product spectrum. It FDI brings not only finance but also know-how and channels for selling onto world markets. FDI statistics are famously unreliable because of the existence of ‘phantom’ flows driven by tax considerations, which account for roughly 40% of FDI flows (Damgaard et al, 2019). Still, the available official statistics, such as those summarized in the UNCTAD annual World Investment Report (UNCTAD, 2019), provide useful pointers in relation to the importance of the phenomenon. Value added of foreign affiliates of multinational enterprises now accounts for 8.5% of global GDP. In 2018, about 52% of FDI flowed into developing countries, equal to 2% of GDP. In recent years, the share of FDI in the service sector has increased.

FDI flows are generally more stable and sustained over the long term than portfolio capital flows, on account of the bulky and difficult to reverse nature of greenfield investment decisions, and those relating to acquisition of ownership stakes. The growth effects of FDI result mostly from knowledge spillovers brought into the host country by the investing entity. Therefore, FDI is key for diversifying the economies of countries at all levels of development.

In manufacturing, FDI is paramount for inclusion in global value chains. These GVCs are crucial vehicles that allows for greater specialization across the production spectrum. GVCs also allow for specialization in services. Especially as the risk of premature deindustrialization is increasing, developing economies must seek opportunities in services, including in new areas such as e-commerce (Rodrik, 2016). FDI in the services sector is key for facilitating this and constitutes the largest share of FDI flows. Much trade in services requires the existence of local entities of service-providing companies. To attract such investments, investors need access to the markets and legal security provided by international investment agreements, especially in jurisdictions where they do not trust the local legal system.

Current provisions on FDI in international law are weak. The OECD’s attempt to develop a Multilateral Agreement on Investment (MAI) failed in 1998. WTO rules cover FDI only to a limited degree (only some provisions under GATS). Bilateral investment treaties (BITs) form the backbone of international investment rules. Since the 1990s, many bilateral investment treaties have been signed, many in North-South relationships. Currently there are 2334 BITs in force, and 315 treaties with investment provisions, which have been replacing pure BITs since the mid-2000s6. While these treaties have indeed increased FDI between signatories by providing greater investment protection, mostly through

Investor State Dispute Settlement (ISDS) mechanisms, few of them include market access provisions. Berger et al (2012) showed that these are important for BITs to be effective in facilitating FDI.

A criticism raised repeatedly against BITs is that the international arbitration procedures under ISDS undermine local sovereign courts. To put ISDS on a different legal footing, the EU is proposing an international investment court system, as in the CETA free trade agreement.

The international tensions that culminated in 2018 in the Sino-American trade war have brought increased usage of investment screening procedures. Market access in China is one of the main complaints raised by the US, the EU, and Japan against China. Furthermore, investment screening due to national security concerns has led to an uptick in the number of new investment restrictions (UNCTAD, 2019).

Another challenge for FDI is the increasing usage of FDI into special purpose vehicles in tax havens, which are used by multinational companies to minimize taxation. ‘Phantom’ FDI is also used by local investors to avoid low degrees of property right protection in some countries. This not only distorts statistics on FDI, but also channels tax revenues away from developing countries that rely more on cooperative taxation.

The OECD base erosion and profit shifting (BEPS) project supported by the G20 tries to address this problem and should stay on the agenda. More generally, a renewed attempt to conclude a Multilateral Investment Agreement would be highly welcomed, and market access is key for diversifying developing economies. Progress on these issues at the multilateral level has stalled and should be supported by the G20. An intermediate step would be the investment facilitation agreements. Investment facilitation has the advantage of preventing controversial market access provisions, while increasing FDI by reducing technical hurdles faced by investors (Berger et al, 2019). Until multilateral agreements are concluded, bilateral agreements have the highest chance of facilitating FDI and increasing economic diversification. Finally, independent of international action, countries can unilaterally open their markets and improve investor protection to increase FDI and harness its positive effects on economic diversification and growth.

The Role of SMEs in Export Diversification

Diversification at both the intensive and extensive margins often requires exploiting market niches. Small and medium size enterprise (SMEs) can play an important role in this regard. Large companies often grow by acquiring smaller companies that have developed such niches. In comparison with large multinational enterprises, SMEs are better equipped to engage in niches as they are smaller, more agile, have lower overheads and, perhaps most importantly, can survive and thrive even in small markets.

SMEs may represent 40% of GDP and 50% of employment worldwide. In emerging markets, SMEs may account for seven out of 10 jobs. SMEs in developing countries export a large and diverse set of goods and services.
services, and are especially active in textiles and garments, gems and jewels, furniture, auto parts, leather and leather products, IT products and services, auditing services, tourism services, and R&D services.

SMEs export directly and indirectly. Despite the rise of e-commerce platforms such as Amazon and Ali Baba, SMEs participate only to a limited degree in direct exports and often choose to avail themselves of the indirect channel, selling their products or services to agents or distributors. Indirectly, SMEs also contribute to exports and to export diversification by supplying intermediate goods and services to larger companies as part of export supply chains.

SMEs can become part of global value chains provided they can meet exacting product or service requirements and standards. World Bank surveys suggest that SMEs in developing countries still participate little in global value chains, mostly as suppliers early in the chain rather than as service providers at the more demanding front of the chain. Challenges hindering SMEs include lack of information about international markets, limited finance, lack of knowledge about international regulations, and cultural and language barriers. Nevertheless, Varghese (2011) has argued that export diversification is difficult to achieve without the contribution of vibrant and innovative SMEs. Oil-rich economies such as Saudi Arabia, where wages are high, are unlikely to achieve significant export diversification without the contribution of SMEs in a range of products and services that rely on differentiation and innovation for competitive advantage.

Policy Recommendations

Export diversification helps promote economic growth and stability in developing nations. These nations account for a large and growing share of global economic activity, but the world trading system presents them with numerous barriers to diversification—barriers that are rising. What can be done? We distinguish between steps that need to be taken at the level of the G20 and steps that individual countries can take on their own.

G20 Trade Policy and the WTO

A rules-based global trading system assures predictability and openness and is essential to promote export diversification. The present system is far from perfect, but it is based on non-discrimination principles and binding market access commitments and is complemented by an effective dispute settlement mechanism to secure enforcement. The WTO (and before it GATT), has provided a solid foundation for rapid economic growth. Yet the system suffers from long-standing pockets of entrenched protectionism in trade in goods—in particular in agriculture—as well as from high barriers to trade in services, which limit countries' diversification potential.

In recent years, the trade policy landscape has deteriorated rapidly and alarmingly. Managed trade is gaining traction, rules are increasingly fragmented in competing spheres of influence, and global trade governance is weakening. In addition, the system needs to catch up with economic and technological transformations, to deal with other distortions, and to move towards more inclusive and sustainable outcomes (Tan and González, 2020).

If countries are to have the opportunity to diversify their exports as a means to grow and reduce volatility, international cooperation is required to revitalize global trade rule-making, and to further
secure open markets, not only in advanced economies, but also in emerging markets, which are critical for geographic diversification and tend to maintain high trade barriers. Priority areas for collective action by the widest range of nations include:

- Reduce and eliminate tariff escalation, tariff peaks, and high tariffs that constrain value addition in both agriculture and manufacturing, in particular in products that have export potential for developing countries.
- Strengthen and update rules to tackle trade-distorting subsidies. In the case of agriculture, domestic support measures that negatively impact production and trade, with high concentration in specific commodities, should be significantly reduced; in the case of manufactures, there is a compelling case for clarifying and agreeing on new rules to govern provision of subsidies by state-owned enterprises, in particular in non-market economies.
- Tighten disciplines on export restrictions and export taxes on natural resources, to avoid disruption to global supply chains.
- Leverage the GATS platform to reignite a round of services trade liberalization, in particular as it relates to cross-border trade and FDI and conclude the ongoing negotiations on disciplines on domestic regulations.
- Adopt a set of rules on investment facilitation to streamline investments, foster transparency, and improve implementation of domestic regulations.
- Agree on a framework to govern digital commerce to reduce transaction costs and create new opportunities and sources of value addition.
- Support the increased participation of micro, small, and medium-sized enterprises in international trade through a set of horizontal and non-discriminatory solutions. Aid programs—provided through bilateral agencies or the International Financial Corporation—can promote the establishment of support centers for SMEs and Aid for Trade Export Promotion Programs, which target in particular opportunities for SMEs. Key areas in which SME’s need support are market intelligence, regulatory information, and financing.

In addition, sorting out the crisis of the WTO dispute settlement mechanism is critical, not only for conflict adjudication but also because it may impact the ability of WTO members in engaging in further rulemaking to support diversification.

**National Trade Policies**

While international economic cooperation is needed to adopt new trade rules and improve access to foreign markets, countries can also adopt unilateral measures to improve their own export competitiveness and realize their diversification potential. National action plans for trade diversification could include the following measures:

- Reduce and eliminate tariffs on raw materials, inputs, and capital equipment to facilitate integration into global and regional value chains and foster technology transfer.
- Revisit non-tariff barriers, to align standards with export markets, reduce the time and cost of compliance, and support a strong quality infrastructure.
- Reduce the high costs of exporting and importing by streamlining border and documentary compliance, and by reducing restrictions to trade in services, which may hinder logistics performance, transport connectivity, and distribution services.
• Liberalize trade in services and adopt an appropriate regulatory framework to foster competition in energy, telecommunications, financial services, and professional services, which are sources of competitiveness for downstream products and services.
• Implement investment-friendly regimes to facilitate, attract, retain, and expand FDI, in particular in non-traditional sectors that contribute to trade diversification and integration into supply chains.
• Adopt legal frameworks conducive to digital trade, including provisions to guarantee free data flows, privacy, and security, among others.
• Support the integration of SMEs into international trade through appropriate trade finance and export promotion measures.

These measures require G20 leadership, with close collaboration between developing and advanced country members, alongside concerted policy reforms at multilateral and national levels. All would benefit from the export diversification and growth acceleration of countries that account for most of the world population.

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