

Global Economy: Trade and Development Report (TDR) 2016

Structural transformation for inclusive and sustained growth reviews recent trends in the global economy and focuses on the policies needed to foster structural transformation. It observes that global economic growth remains weak, growing at a rate below 2.5%, and global trade slowed down dramatically to around 1.5% in 2015 and 2016, compared to 7% before the crisis.

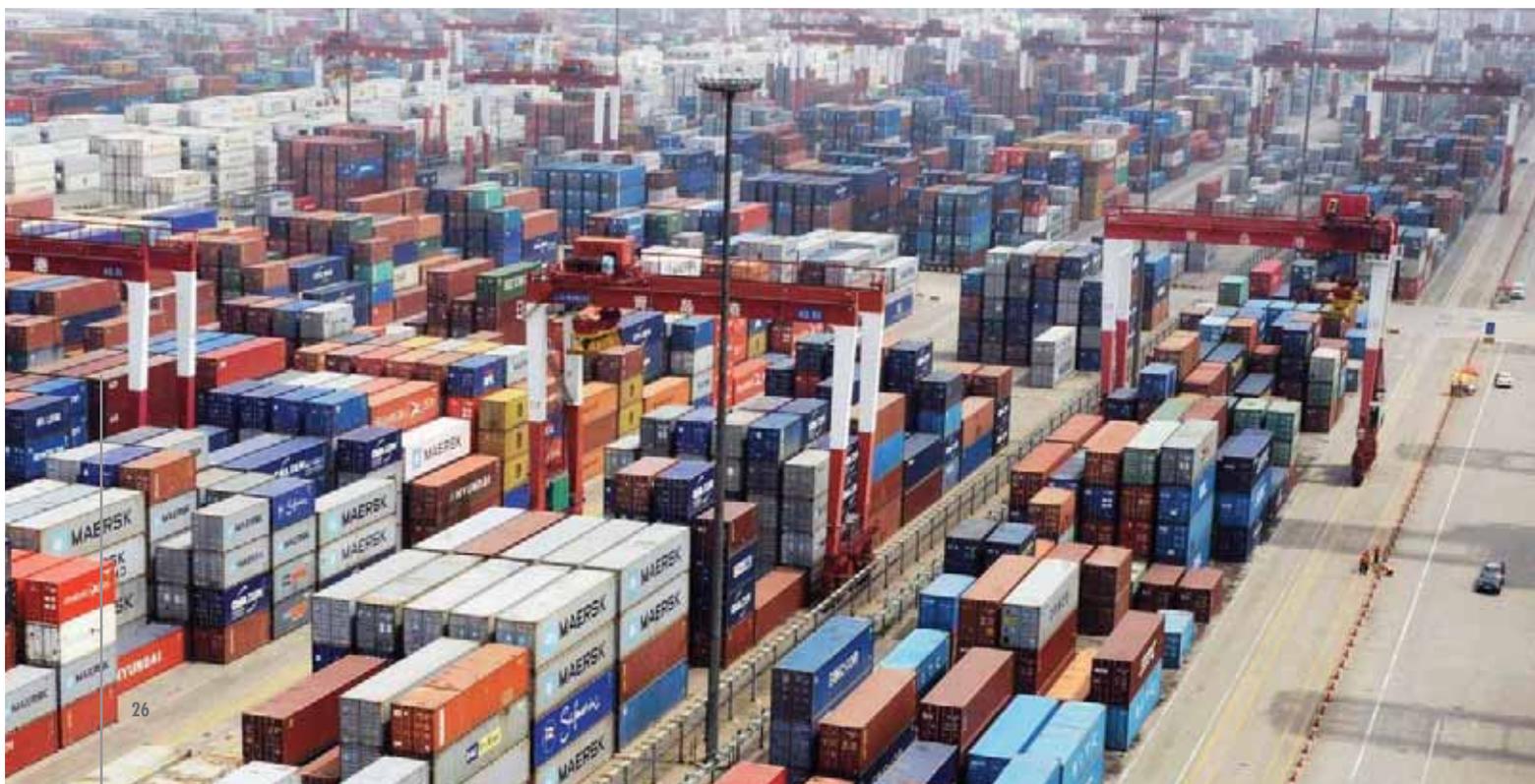
The loss of dynamism in the advanced economies, combined with low commodity prices and global financial instability, is having knock-on effects on most developing countries. Developing economies will grow on average less than 4 percent this year, but with considerable variation across countries and regions: while Latin America is in recession and growth in Africa and West Asia is slowing down to around 2%, East, South-East and South Asia is still growing at a rate close to 5%.

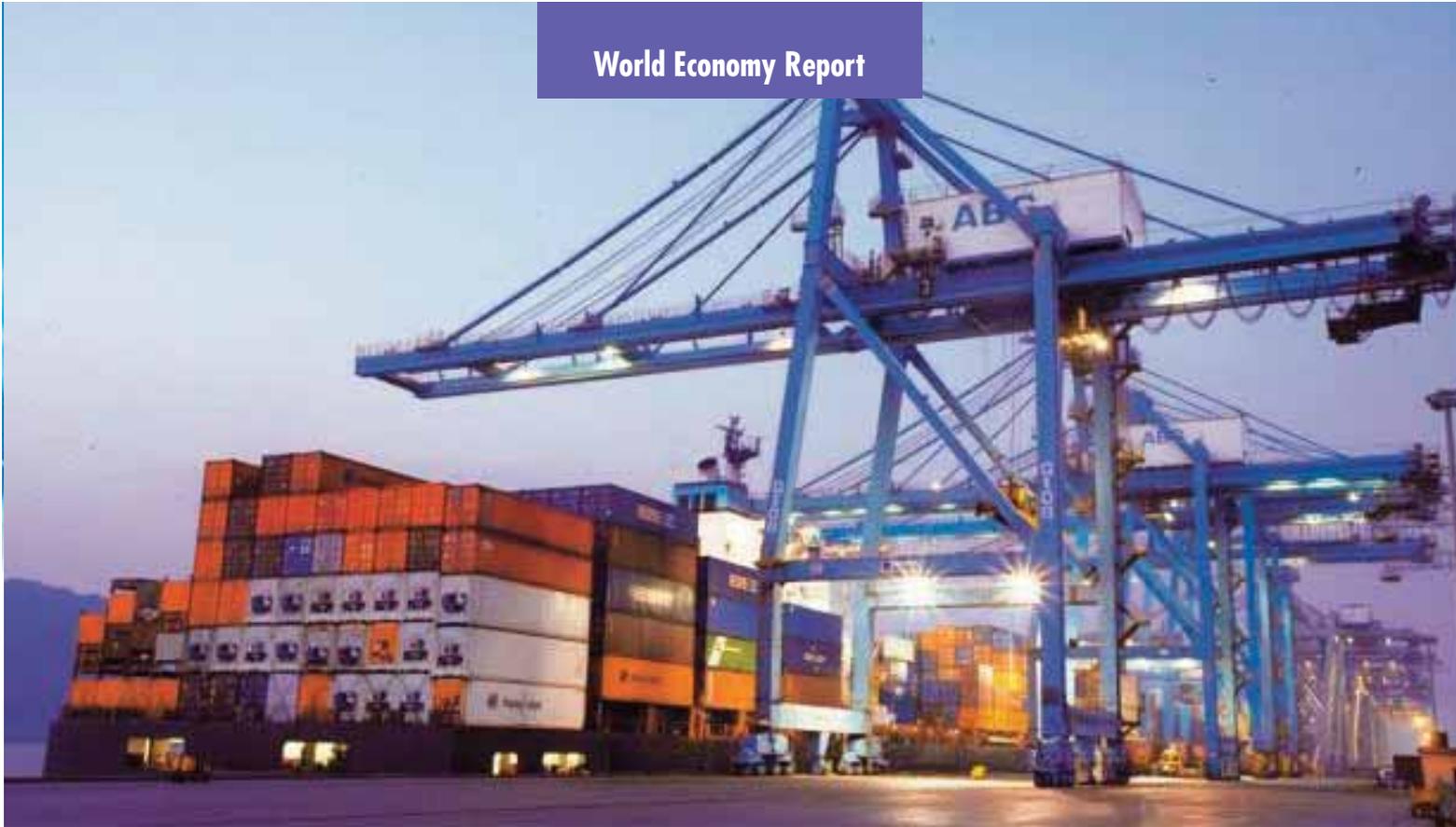
Considered in a long-term perspective, most developing countries outside some Asian sub-regions have failed to significantly reduce the income gap with developed economies. The big investment push in developing regions remains one of the unfulfilled promises of the more open global economy set in place in the 1980s and 1990s; and after general growth accelerations at the beginning of the century, convergence is now losing steam with a more challenging international environment. To attain sustained and inclusive growth, countries need to adjust their policy strategies in order to advance structural transformation.

To that end, proactive industrial policies are needed to encourage the shifting of employment and resources from low-productivity agriculture to higher productivity industrial and modern services sectors. Manufacturing activities play a

key role in such processes, as they create formal employment, incomes and demand, and accelerate productivity growth; this in turn further boosts incomes and demand. However, many developing countries have not been able to develop sufficiently their manufacturing sector (experiencing a "stalled industrialization") or have even endured a "premature de-industrialization" since the 1980s owing to a policy strategy centred on unilateral trade opening, financial deregulation and the retreat of the developmental State.

As important as expanding the share of manufacturing in total employment and value added is to strengthen its production and knowledge linkages to the rest of the economy, particularly the primary sector and modern services. Similarly, expanding exports of manufactures can support industrialization pro-





vided that exporting sectors have strong production and learning linkages with the rest of the economy, as it was the case in successful Asian catching-up experiences. However, export-led growth is today more difficult, due to the fallacy of composition, weaker demand in developed countries and weak productive linkages in enclave-type export-oriented activities. Therefore, countries need to combine production for global, regional and domestic markets.

Structural transformation needs high levels of investment, but the profit-investment nexus has weakened in recent times. With the 'shareholder primacy' in corporates' strategies and their increasing focus in short-term profits, corporations (especially in developed countries) have been increasingly using profits to pay dividends and to repurchase shares instead of reinvesting them in new plant and equipment, research and skill acquisition. Also in large developing economies the investment-to-profits ratio in leading firms has declined, as profits are increasingly reoriented to financial investment or repatriated by transnational corporations.

Against this background, TDR 2016 identifies some of the critical issues to be addressed in order to set in place structural transformation processes:

- ❖ Industrial policy is an essential tool for all countries. It does not consist only in

supporting a number of key sectors to diversify and upgrade the economy, but also in the construction of linkages and capabilities to build a production base fit for purpose in a rapidly changing world, in which flexibility and policy space are key.

- ❖ Structural transformation requires a comprehensive policy approach. This includes strategic policies for international trade, pro-growth macroeconomic policies to ensure high levels of aggregate demand and a stable and competitive exchange rate and policies in support of the profits-investment nexus.
- ❖ Changing corporate governance and recovering public investment are needed to reinvigorate the profit-investment nexus and spur productive investment. Taxation rules can facilitate profit reinvestment and reduce incentives for debt financing, and should also address tax erosion that

hinders public investment. The financial system should provide adequate credit and liquidity to small and medium enterprises.

- ❖ A strategic approach to international trade needs to address with pragmatism the choices of processes, products and markets, developing the production and learning linkages between the exporting sectors and the rest of the economy.
- v Successful transformative experiences have demonstrated the capacity to develop institutions and rules and norms that provide a stable framework for economic activity while being flexible to respond to specific situations. These policies and institutions generally are part of a developmental state with a stable bureaucracy, closely connected to, but independent of, the business community. ◆

