

CALL FOR INPUT

BY

THE KATOWICE COMMITTEE OF EXPERTS

**ON THE IMPACTS OF THE IMPLEMENTATION OF THE
RESPONSE MEASURE:**

**A. WRITTEN SUBMISSION ON JUST TRANSMISSION OF THE
WORK FORCE AND CREATION OF DECENT WORK AND
QUALITY JOBS (A CASE STUDY OF NIGERIA)**

B. ECONOMIC DIVERSIFICATION AND TRANSFORMATION

BY

ASABE SHEHU YAR'ADUA FOUNDATION

Membership/Affiliates:

- UNITED NATION DEPARTMENT OF PUBLIC INFORMATION (UNDP/DPI)
- UNITED NATIONS OFFICE ON DRUGS AND CRIME (UNODC)
- ECONOMIC AND SOCIAL COUNCIL (ECOSOC)
- Green Climate Fun (GCF)
- UNFCCC United Nations Framework Convention on Climate Change
- AFRICAN UNION
- EUROPEAN UNION
- UNITED NATIONS COMMISSION ON HUMAN RIGHTS (OHCHR)
- UNITED NATION ENABLE, RIGHT OF PERSONS WITH DISABILITIES

- OFFICE TO MONITOR AND COMBAT TRAFFICKING IN PERSONS, U.S DEPARTMENT OF STATE
- GLOBAL MODERN SLAVERY
- GLOBAL FUND TO END SLAVERY
- WORLD ASSOCIATION OF NGOS (WANGO) AS A REGULAR MEMBER, USA
- WORLD CODE OF ETHICS AND CONDUCT FOR NGOS
- UNICEF USA IN THE FIGHT FOR CHILD SURVIVAL
- EUROPEAN COMMISSION WITH ID NO: NG-2009 FUI-3110223990
- NIGERIAN NETWORK OF NGOS (NNGO)
- NIGERIA – FEDERAL MINISTRY OF WOMEN AFFAIRS AND THE 36 STATES
- MINISTRIES OF WOMEN AFFAIRS
- NATIONAL COUNCIL OF CHILD RIGHTS ADVOCATES OF NIGERIA (NACCRAN)
- NIGERIA – NATIONAL AIDS CONTROL AGENCY AND STATE AGENCIES ON AIDS
- ROTARY CLUB INTERNATIONAL
- ECOSOCC AFRICA
- NATIONAL POPULATION COMMISSION
- NATIONAL HUMAN RIGHT COMMISSION
- INEC OBSERVER FOR GOOD GOVERNANCE
- UNESCO
- FEDERAL MINISTRY OF YOUTH DEVELOPMENT
- FEDERAL MINISTRY OF INFORMATION
- UNITED NATION MILLENNIUM DEVELOPMENT GOAL (MDGS)
- SUSTAINABLE DEVELOPMENT GOALS (SDGS)

DEFINING JUST TRANSMISSION OF THE WORK FORCE AND CREATION OF DECENT WORK AND QUALITY JOBS

A “just transition” is about achieving decent work for all and eradicating poverty through growing inclusive economies that can meet the needs of the world’s growing population while also protecting the environment and natural resources on which life on earth depends. The greening of economies, enterprises and jobs must be seen in the context of sustainable development. The Guidelines for a just transition towards environmentally sustainable economies and societies for all adopted by the ILO Governing Body (ILO 2015) provide practical orientation to Governments and social partners on how to formulate, implement and monitor a just transition policy framework in accordance with national circumstances and priorities.

The ILO developed a methodology – the Rapid Situational Analysis – to identify areas for just transition policies at national level. The analysis follows two subsequent steps. First, it examines the link between the economy, employment and nature. Thereby, it provides a detailed picture of the economic structure and labour market at sectoral level in relation to the natural environment and climate change. Second, it investigates the national policy framework in the context of employment promotion, skills and human capital development, social protection and other dimensions of decent work, and identifies key just transition policies. The objective is to identify win-win policies for the environment and employment, which maximise job creation, minimize negative effects and protect the vulnerable.

In the analysis, four key indicators are used –gross domestic product (GDP), decent work, greenhouse gas emissions and vulnerability to climate and environmental change – to identify key sectors of the economy and segments of the labour market where there is a necessity to ensure a transition to environmental sustainability, while addressing simultaneously objectives of economic development and social inclusion. Particular attention is given to the working poor, farmers and rural population, and women. Decent Work is understood as providing equal employment opportunities for men and women, rights at work, social protection and social dialogue.

The selected sectors are further assessed to better understand the sector-specific linkages between the economic, employment, environmental, and policy dimensions. The national policy framework analysis examines the link between national priorities and just transition policies. Potential gaps within the policy framework are detected. Finally, the report presents key just transition policies in selected sectors of the economy.

The structure of the report is as follows.

Following the Introduction, Section 2 provides a brief overview of Nigeria followed by a detailed analysis of the structure of the economy and the labour market at sectoral level. The link between economic sectors, the labour market, and climate and environmental change is assessed using the four key indicators mentioned above. Section 3 presents the national policy framework relevant for just transition policies and concludes with a policy-oriented summary.

The employment-environment-climate nexus

Nigeria is a lower middle-income country with a population of over 200 million, which represents close to half of West Africa's population. It has one of the largest youth populations in the world (70 per cent of the population is under the age of 35). Possessing significant reserves of oil and gas, Nigeria, together with Angola, Algeria and Libya, is among the largest oil producers on the African continent (producing around 2 million barrels a year) and is among the 15 biggest producers globally. It is also the largest economy in Africa. Nigeria's Gross Domestic Product (GDP) was at 397 billion United States dollars in 2018, with an annual growth rate of 1.9 per cent. GDP per capita was of US\$2,028 (World Bank 2018).

Oil accounts for more than 95 per cent of exports and foreign exchange earnings, while the manufacturing sector accounts for less than 1 per cent of total exports. Despite high GDP growth in the period 2011–2015, driven by high oil prices, the economy remained largely non-inclusive. The majority of Nigerians remain under the burden of poverty which impacts close to 70 per cent of the population. Inequality, as measured by the Ginicoefficient, where 0 stands for full equality and 100 where all income goes to 1 person, stands at 43 (more equal than South Africa's 63, but significantly higher than EU's average of 30).

Underemployment and unemployment rates are very high (over 40 per cent). The country's resource-based economy shows signs of Dutch disease and resource curse, whereby despite having abundant endowments of natural resources, the country performs worse in terms of economic development, employment and social indicators, than countries with fewer resources. It is affected by precarious social services, including poor health and schooling facilities and lack of road, rail, energy and transport infrastructure, notably in rural areas and with a significant north-south divide. Oil is mostly produced in the Niger Delta in the South, with Lagos, the business centre, exhibiting much higher living standards and public services than the far North.

In terms of governance and politics, Nigeria is a federal republic with 36 states that returned to democratic rule in 1999. After more than 30 years under a military regime, Nigeria gained in political stability and basic freedoms.

Economic structure

In terms of the structure of the economy, Nigeria can be classified broadly into oil and non-oil sectors. Oil revenues contribute to two thirds of state revenues and 8.6 per cent of GDP. Other major economic sectors in terms of contribution to the GDP are agriculture (24 per cent), trade (18 per cent), mining and quarrying (11 per cent), manufacturing (9 per cent), and information and communication (9 per cent) (NBS 2018).

The link between labour market, economy, and environment and climate

The link between Nigeria's economic structure, labour market, and environment and climate, manifests itself in three ways:

- i. First, climate change and environmental degradation trigger negative impacts on economic activities and jobs.
- ii. Second, economic activities and jobs produce negative environmental impacts through pollution and destruction of nature.
- iii. Third, policies and regulations to address and restrain climate and environmental impacts have impacts on economic activities and jobs. On the other hand, incentives and support policies may stimulate climate friendly and green sector growth. This third point is addressed in the policy section below.

i. Impacts of climate and environmental change on key sectors and jobs

Nigeria is recognized as being vulnerable to climate change. The Climate Vulnerability Index (CVI) is being proposed to assess climate change vulnerability. The index consists of parameters in the three dimensions of vulnerability defined by the IPCC: Exposure, Sensitivity and Adaptive Capability. Exposure is defined by 'Natural disaster and Climate variability', Sensitivity by 'Health', Food', and 'Water' and Adaptive Capability by 'Socio-demographic profile', 'Governance and Institutions', 'Livelihood strategies', and 'Social networks' among other (Chen et al 2015).

A variety of indexes have been developed to measure the vulnerability of countries to environmental risks. For example, the University of Notre Dame proposes an index based on the IPCC criteria and ranks Nigeria 127th among 180 countries assessed. Importantly, the single highest risk category is "Agriculture capacity" and "Projected change of cereal yields" which other studies estimate could be reduced by 25 per cent in the case of rice cultivation (Chen et al 2015)

The total agricultural land, estimated at almost 71 million ha, has an irrigation potential between 1.5 to 3.2 million ha out of which only 1 per cent is irrigated (FAO 2016). While floods will likely become more severe in southern areas, droughts are expected to be more frequent in the savannah north. Desertification is by far the most pressing environmental problem in this region along the border with Niger. Nigeria is presently losing about 351,000 km² of its land mass to the desert which is advancing southward at the rate of 0.6 km/year. Under a business-as-usual scenario, agricultural productivity could decline by 10–25 per cent by 2080. The north of the country is most vulnerable to climate change as the decline in yield in rain-fed agriculture could be as much as 50 per cent. Agriculture decline would also affect GDP, reducing it by 4.5 per cent by 2050 (UNFCCC 2015).

The share of the informal sector is 92 per cent, the highest share among all sectors in the country. This reflects a high number of working poverty and workers lacking social protection coverage. The sector also comprises a large share of youth and migrant workers.

Environmental impact of key sectors and jobs

In terms of climate impacts, Nigeria is not a large emitter of greenhouse gases, contributing less than 1 per cent of global emissions (460 Mt CO₂eq in 2014). However, it is the second highest emitter among Sub-Saharan countries. And, mainly because of high population growth, a business-as-usual scenario would double the emissions by 2030.

Latest statistics from Nigeria's submission to the UNFCCC from 2014 show that 38.2 per cent of GHG emissions came from land use change and the forestry sector, followed by energy, waste, agriculture and the industrial processes sector which contributed 32.6, 14.0, 13.0 and 2.1 per cent respectively. Within the energy sector transport, electricity and fugitive emissions from oil and gas are the most important sources.

Key sector selection: agriculture and energy

The rapid analysis above outlined the link between the economy, employment, and climate and environmental change. Using the four key indicators of GDP, Decent Work emissions and vulnerability, energy and agriculture appear as the two economic sectors, which require the largest and most profound restructuring to achieve sustainable economic and social development. Those sectors are also in line with the national development priorities.

Just transition policies – identifying entry points in the national policy framework

This section discusses just transition challenges and opportunities in Nigeria per sector. The section concludes with an analysis of the national policy framework and how it reflects or may reflect just transition measures.

The impact of climate policies on economic activities and jobs

With regard to climate policies, efforts to reduce greenhouse gas emissions (mitigation), if taken in isolation, may negatively affect the energy, forestry and agriculture sectors, which together are responsible for more than 80 per cent of total emissions. However, depending on the type of mitigation policies and accompanying just transition measures, economic growth may be stimulated and job opportunities created. For instance, jobs may be created or transitioned from thermal power jobs to jobs in the off-grid solar sector, in energy efficiency and in grid expansion. Likewise, opportunities for job creation and transformation are likely to emerge through climate smart agriculture and reforestation, alternative cooking fuel and agro-processing. This in turn reduces vulnerability and drives sector growth to transition in a just and inclusive way towards an environmental friendly and resilient economy.

Review of the national policy framework

This section briefly summarizes the content of the main policy strategies and their relationship to just transition policies. It seeks to identify the extent to which national strategies relevant for a just transition acknowledge environmental challenges, employment costs/opportunities, and the linkages between the two.

Economic Recovery and Growth Plan (ERGP) (2020–2050)

The ERGP articulates the Government’s vision for the country for the period 2017-2020, and lays the foundation for long-term growth. The ERGP focuses on three strategic objectives: restoring growth, investing in people, and building a competitive economy. The Plan targets a growth rate of 7 per cent by 2020 driven by strong non-oil sector growth anchored in agriculture and food security, energy, transportation and industrialization. It foresees investment in people by improving access to healthcare and education, promoting social inclusion and creating jobs. To build a competitive economy, it aims at accelerating infrastructure development and improving the ease of doing business.

To achieve the objectives of the ERGP, the key execution priorities are:

- i. stabilizing the macroeconomic environment;
- ii. achieving agricultural transformation and food security;
- iii. ensuring energy sufficiency (power and petroleum products);
- iv. improving transportation infrastructure;
- v. driving industrialization, focusing on small and medium-sized enterprises.

The targets on employment, business development and energy build on existing sectoral strategies and plans such as the National Industrial Revolution Plan and the Nigeria Integrated Infrastructure Master Plan.

Nigeria Industrial Revolution Plan (2012–2017)

The Nigeria Industrial Revolution Plan (NIRP) launched in 2012 provides a strategic and integrated roadmap towards industrialization, which continues influencing the strategies of the current government. NIRP provides a plan across three sectors: agro-allied, solid minerals and oil and gas-related industries, where Nigeria's comparative and competitive advantage are apparent.

The Nigeria Industrial Revolution Plan is a five year plan to rapidly build up industrial capacity and improve competitiveness in the country. The plan identifies industry groups where it has comparative advantage: agro allied and agro processing, metals and solid minerals processing, oil and gas-related industries, construction, light manufacturing, and services. Building up industrial skills, an adequate infrastructure and business environment are key aspects.

National Employment Policy (2017)

The National Employment Policy (NEP) results from a revision of the previous policy adopted in 2002. Its goal is to create the enabling environment for productive and employment-intensive growth in Nigeria. Among the objectives of the policy are: full employment, non-discrimination, promotion of skills and competencies in formal and informal sectors, especially in rural areas, formalization, enhanced integration of migrant labour, creation and maintenance of labour market information system, ensuring social protection.

The promotion of environmentally friendly (green) jobs is mentioned as one scope of action of the policy and composes one of the policy targets. Green jobs would be created in the context of climate change adaptation measures, in the renewable energy sector, urban waste recycling and afforestation. Labour-intensive public works are foreseen in the policy., In order to create decent work, in particular for the youth, the policy also emphasizes sector value chains, such as agriculture, , mining and solid mineral extraction, manufacturing in the textile sector, entertainment sector and tourism.

Intended Nationally Determined Contribution (2015)

Nigeria's Intended Nationally Determined Contribution (INDC) takes an approach that focuses on the delivery of development benefits and sustainable growth of the economy as a response to the constraints to human and economic development arising from poverty, food insecurity, poor access to energy and high unemployment.

Just transition policies

This section looks at the match between sectors identified as requiring priority attention in the pursuit of a just transition, and national policy strategies. Such analysis allows to consider the extent to which the existing institutional and policy framework may be subject to revision in order to reflect and ensure a just transition. The key sectors identified in this paper are energy and agriculture. A structural change is required in those sectors to achieve development, which is high-growth but low-carbon with reduced climate risk. Within those sectors deforestation, transport, power, and oil and gas are critical for reducing emissions. Agriculture and agro-processing are key for broad based and inclusive growth, which is low climate risk. As the main national development plan, the Economic Growth and Recovery Plan recognizes the importance of the agriculture and energy sectors. However, it may provide a stronger link to climate and just transition policies. At the same time the National Employment Policy reflects key aspects of just transition policies, but does not link them to the climate and environmental context. Finally, sectoral policies in energy and agriculture may benefit from the inclusion of just transition policies by linking the development strategies to employment, social and environmental goals as well. In terms of just transition policies to enable and drive structural change in the energy and agriculture sectors, skills and enterprises development are considered primary levers of action. Social protection policies, including insurance mechanisms, are critical to ensure reduced vulnerability and climate risk for workers, enterprises and communities engaged in agriculture.

Potential entry points for interventions in agriculture, land use and forestry:

- i. Building resilience of agricultural production: promotion of MSMEs, in particular among youth, enhancing the ability to cope with climate change effects on crops and livestock.
- ii. Skills and enterprise development for climate-smart agriculture in the context of mitigation efforts, including reforestation and halting desertification.
- iii. Skills and enterprise development for alternative clean cooking solutions, including improved cook stoves, alternative energy sources (LPG), eco-charcoal production from waste, sawmills, and small household-size animal-waste-fed bio digesters.
- iv. Social protection for agricultural workers: mainstream environmental risks into social protection and insurance systems.
- v. Developing models of payment for ecosystem services to alter the opportunity cost of clearing forest areas.

Potential entry points for interventions in the energy sector (power, oil and gas, transport):

- i. Skills identification and anticipation with a focus on renewable (solar).
- ii. Skills development targeted at new skill requirements in the traditional energy sector, including technicians required for technology ending gas flaring, double-cycle gas generators and more energy efficiency.
- iii. Skills development in emerging and renewable energies – solar and wind – notably off-grid solar installers, managers and maintenance service.

Potential institutional set-up/Conclusion

To ensure a just transition for all, policy coordination and coherence are required between sectoral policies (energy, agriculture), economic policies (economic growth plan), environmental/climate policies (nationally determined contributions on climate adaptation and mitigation) and employment and social policies (education and training, enterprise development, social protection).

In addition, social dialogue can allow for stakeholder-wide consultation and coordination. Social dialogue can consist of all types of negotiation, consultation or simply exchange of information between, or among, representatives of governments, employers and workers, on issues of common interest relating to economic and social policy. In practice, government and line ministries as well as employers' and workers' organizations are main stakeholders to engage in continuous dialogue in policy formulation and implementation.

The use of existing institutional set-ups, such as the Inter-Ministerial Committee on Climate Change, and/or existing consultation mechanisms for national development planning and the Revised Economic Growth and Recovery Plan, are well suited to include additional key social partners and stakeholders, and engage in continuous social dialogue.

This will ensure broad-based consensus and support for the policy direction taken, safeguard peace, ensure the inclusion of the disadvantaged and marginal voices, and enable a timely and successful implementation.

B. ECONOMIC DIVERSIFICATION AND TRANSFORMATION

DEFINING ECONOMIC DIVERSIFICATION

Economic diversification can be defined as the shift toward a more varied structure of domestic production and trade with a view to increasing productivity, creating jobs and providing the base for sustained poverty-reducing growth. Domestic production diversification results from the shift of domestic output across sectors, industries, and firms. It captures the dynamics of structural transformation, because successful diversification of domestic production entails resource reallocation across and/or within industries from low productivity activities to those with higher productivity. For its part, trade diversification occurs in three ways: (a) the export (or import) of new products (goods or services); (b) the export (or import) of existing products to new markets, and (c) the qualitative upgrading of exported (or imported) products. Trade diversification, quality upgrading and the sectoral diversification of domestic production are often closely linked. Trade is often a key factor behind economic diversification. Indeed, integration into the global economy lies behind the success of countries in east Asia in diversifying into manufacturing which in turn has driven unprecedented poverty reduction. Export diversification is an objective in itself to reduce vulnerability to adverse terms of trade shocks and stabilise export revenues, as well as driving output diversification. Indeed, export diversification appears to be associated with less output volatility in low-income countries as well as faster sectoral reallocation. The empirical evidence also shows that quality upgrading of export products is closely correlated with greater impact of domestic production diversification on productivity growth (IMF, 2014). Economic diversification is no longer seen as simply requiring the emergence of new industries. In the past, the focus was on the development of whole industries and the movement of resources between old (low productivity) and new (higher productivity) sectors. This typically required investments in all elements of production within a sector. There are today many more routes towards diversified economies. Firstly, there has been an increasing focus on firms and firm-level characteristics and performance and the process of reallocation of resources between low productivity firms and high productivity firms, including within existing industries. For example, there is now a considerable body of evidence to suggest that within sectors, firms that export enjoy productivity and wage premia relative to those that do not. Secondly, technological change and the secular decline in transport costs has led to the splitting up of production and the emergence of regional and global value chains where distinct activities or tasks are undertaken in different countries according to where it is most efficient to locate activities and manage the value chain. Thirdly, pro-competitive

regulatory reform and the decline of communication costs has enabled developing countries to greatly expand their participation in trade in services, many of which provide relatively high productivity activities compared to traditional agricultural or manufacturing activity. By supplying three in five jobs held by women worldwide, and four in five jobs within the G20 grouping accounting for 80 percent of global trade, the trend towards increasingly service-centric forms of development also shows important gains in inclusiveness.

The above considerations recall how concentrating on the output of manufacturing sectors may not be sufficient to identify the scope of opportunities for economic diversification. Furthermore, the splitting up of value chains implies that countries should not just be looking to exploit opportunities to produce and export final products but also exploring possibilities with regard to intermediate inputs. Diversifying the range and quality of imported inputs can support quality upgrading and productivity growth in existing sectors and allow new varieties of products to be developed. Producers of inputs can explore the densification of their value chains (diversification toward new uses of a given product) to access new markets and reduce vulnerability to product-specific shocks. This not only means a much richer menu for discussions on diversification but also the need for a more varied set of diversification metrics.

THE POLICY AND INSTITUTIONAL FRAMEWORK FOR DIVERSIFICATION

There is no magic recipe for diversification. There are, however, multiple paths to successful diversification. In countries at very low levels of economic development, the priority is typically to get the fundamentals right. As countries develop, multiple diversification paths may become available. Malaysia, for instance, was previously a primary commodity-based economy. Today it is integrated into global value chains across a wide range of (primarily manufacturing) industries, has expanded into new products and markets and upgraded the sophistication of its export mix. Chile opted for upgrading its traditional resource-dependent export industry (i.e., development of ancillary and logistics services to support the expansion of the copper exporting industry); and for domestic diversification toward new agricultural exports (i.e. development of the salmon and wine exporting industry). Long an exporter of a limited mix of agricultural commodities (bananas and unprocessed coffee), Costa Rica has made insertion in regional value chains and the attraction of FDI needed to sustain it a centerpiece of the country's development strategy over the past decades. At latest count, the country's export mix exceeded four thousand products, chief among which medical devices and IT components alongside a host of high value-

added services. Much like Costa Rica, the United Arab Emirates are well-endowed with an efficient bureaucracy, stable macro-economic framework, good infrastructure, and a privileged location. It followed a diversification strategy focused on exporting new business services, exploiting agglomeration externalities and building a low-cost business platform.

Everywhere, the trade and investment policy agenda lies at the heart of a strategy for economic diversification. Providing the foundations for structural transformation and private sector driven-growth is an essential element in achieving a broader base of economic activities. No country has experienced sustained growth and significant reduction in poverty without integrating into the global economy. Development partners can assist developing countries to put in place the following key basic elements: (i) an appropriate incentive framework through reforms to the business and investment climate, reviewing trade and investment policies to remove bias against exporting and ensuring effective competition in product and factor markets and in key backbone services such as transportation, finance, energy and communications. (ii) investments and policy reforms that reduce trade costs – declining trade costs and efficient trade logistics were at the heart of the success of East Asian countries in integrating into the global economy and achieving more diversified economies with not only more, but also better jobs. (iii) effective policies to support adjustment and the reallocation of resources to new activities – from declining sectors but also from the informal sector and new entrants to the job market. (iv) government interventions that target specific market, policy and institutional failures.

This approach provides an analytical base upon which a country can define a strategy to address the essential policy requirements for private-sector driven diversification. Each country should of course define its own route to a wider range of trade and production activities that reflects underlying endowments, comparative advantages and national characteristics, including the profile of poverty, availability of skills, institutions and governance conditions and prevailing political economy constraints. This will typically lead to a mix of cross-cutting, sector-focused and geographically targeted measures that will vary across countries, ideally defined in close consultation with the private sector (domestic and foreign) and regularly fine-tuned as the development process unfolds. For example, the route to diversification for a small resource-rich country with relatively high wages will likely be very different to that of a large resource rich country with low-wages. The approach described above also provides a general step-wise sequencing of priority measures. The initial focus should be on addressing a country's incentive framework. There will be little point in

investing heavily in infrastructure to reduce trade costs or in developing measures to support the movement of resources or targeting specific market failures if the incentive framework remains highly distorted and there is a strong bias against exports or if the sectors face significant entry barriers in the form of tariff or non-tariff barriers. In this case, active policies are likely to exacerbate the misallocation of resources. On the other hand, in countries that have been able to put in place an appropriate incentive structure and have efficient backbone services and relatively low trade costs, the policy focus can turn more to facilitating adjustment and targeting more specific market failures. The sequencing of policies targeted at economic diversification should also take account of the implementation capacity of governments. For example, the implementation of industrial policies has often been undermined by imperfect knowledge of the externalities and spillovers that warrant sector specific interventions and the vulnerability of such interventions to corruption, manipulation, and rent-seeking conduct. Countries with weak institutions and limited capacity to implement complex policies, typically those with lower incomes, will tend to face greater risks when implementing industrial policies as opposed to focusing limited resources on removing disincentives to diversification and delivering essential public goods. Countries with weak institutions often face significant political economy challenges in implementing a diversification strategy. Countries with a limited economic base, especially when dependent on high-value minerals, will often see political activities focused on rent-seeking behaviour and efforts to capture available economic rents. Despite strong economic arguments for the long-term benefits of diversification, this environment makes it difficult to implement necessary economic reforms. Successful strategies for diversification will therefore be based on a careful understanding of the underlying political environment, the main actors and how they wield power, the institutions that influence how that power is moderated and the potential impact of external factors, including regional institutions and partners such as the World Bank and other development agencies. For many countries, compliance with WTO disciplines, acceding to the world trade body, regional integration schemes and deep preferential agreements entered into with key trading partners can all represent powerful anchoring mechanisms to overcome domestic resistance to change by providing binding commitments that help to lock in reforms necessary for diversification. Effective collaboration between development partners and international organisations is essential to support the implementation of a diversification strategy. There are a range of issues that require working together in partnership, for example, on addressing infrastructure constraints that raise trade and logistics costs in coordination with reforms that reduce trade barriers and increase competition among the providers of services along that trade-related

infrastructure. The effective implementation of reforms that address policy failures requires a careful assessment of governance restrictions and political economy constraints. Efficient reallocation of resources across sectors or firms depends upon labour market policies and access to finance, among other issues.

THE INCENTIVE FRAMEWORK FOR DIVERSIFICATION

The World Bank Group's experience in advising governments on economic diversification suggests that there are three key areas of economic incentives that intersect to affect the framework for diversification. These are: i) business regulation and investment policy; ii) trade policy design; and iii) competition policy.

Business regulation and investment policy

Clear, transparent and predictable business regulation that provides a level playing field among investors - small and large, domestic and foreign - are essential for economic diversification. Business regulations such as those governing credit markets, the hiring and firing of workers, quality standards, the procedures and licenses required to start a business, contract enforcement and insolvency – all form an essential part of the incentive framework to encourage investment in new activities. In environments with a poor investment climate, the lack of competitive domestic suppliers, combined with inefficiencies in factor markets and institutional capacity constraints, hinder diversification. There are three main ways in which business regulation and the investment climate condition the incentives towards diversification:

- By reducing the costs of investing in new activities and by improving the efficiency by which resources move from declining firms and sectors towards more dynamic firms and sectors. The time and cost of opening a business can affect entrepreneurship and the ability of firms to respond to emerging opportunities within existing and in new industries. Similarly, effective bankruptcy regimes that facilitate exit and encourage risk-taking constitute an important incentive for market entry. The effectiveness of entry and exit regulations can also foster competition among incumbent firms and their incentives to invest and innovate. Exit regulations affect how quickly resources trapped in unviable firms can be reallocated towards more efficient uses. Restrictive entry regulations disproportionately penalise industries characterised by greater experimentation, such as ICT-intensive sectors (Andrews and Cingano, 2014; Aghion et al., 2006).

- By affecting day-to-day business operations and investment decisions. These include tax regulation, credit market and labour market regulation. The extent to which these regulations are evenly applied matters for the efficiency with which resources are allocated across different sectors and firms. If discriminatory regulations allow less productive firms to survive and expand at the expense of more productive ones, diversification efforts will likely fail (Bartelsman et al., 2010; Hsieh and Klenow, 2009). Similar outcomes may arise when inefficient firms, including state-owned enterprises are propped up through distortive subsidy practices.
- By providing a predictable and transparent business environment, reducing the risks associated with testing new products and markets. Effective enforcement of rules and sound intellectual property rights enable firms to internalise the economic benefits of innovation, encouraging investment. A transparent and non-discriminatory regulatory environment, including appropriate investor protection laws, can promote investment in riskier activities that have potentially long-term payoffs. An emerging literature on economic policy uncertainty suggests a positive effect of predictability on investments, especially for large firms and sectors characterised by irreversible investments (Baker et al., 2015; Bartelsman et al., 2010).

Trade policy

The nature and structure of protection in overseas markets shape the opportunities for export diversification in developing countries. This is especially so if overseas protection is biased towards products in which a country enjoys a comparative advantage. For example, tariff escalation (the cascading of import tariffs according to the degree of processing) in developed countries has long constrained opportunities for developing countries to add value to and develop additional activities around agricultural and mineral products.⁴ Similarly, for light manufacturing, import tariffs on products such as clothing and shoes are typically much higher than those on textile fabrics and leather. To some extent, this constraint has been alleviated by multilateral trade liberalisation through the WTO which has reduced tariff peaks in rich countries and through the provision of non-reciprocal tariff preferences for developing countries, although the latter are frequently undermined by unduly restrictive rules of origin. Nevertheless, an important challenge for developing countries, especially the poorest, is to better leverage trade preferences to drive export diversification. Regional integration and deepened South-South trade also represent effective mechanisms to

increase new market opportunities for exporting firms. Diversifying exports to higher income markets is often more difficult than diversifying exports to regional markets. Standards are often higher, requiring larger investments to raise quality and meet higher health and safety requirements (ITC, 2016). Developed country buyers may also demand very large consignments, requiring substantial investments in capacity. For this reason, diversification through exports to nearby countries with similar tastes and regulatory requirements – and hence potentially lower compliance costs - may prove easier. So will South-South trade. Expansion in such markets can then provide the springboard for enlarged access to the global market once experience with exporting has increased and awareness or product requirements in other markets has been accumulated. Tariffs on imports can act as a constraint to export diversification and to sustained insertion in regional or global production networks. The level of import protection determines the incentives to produce exportable goods by directly raising the domestic price of imports relative to exports. It has long been known that there exists a symmetry (or equivalence) between the effects of an import tariff and an export tax on domestic relative prices. Import tariffs also indirectly alter the price of exports relative to the prices of (non-traded) goods produced solely for the domestic market. Since a tariff raises the price of imports, consumers will shift consumption toward non-traded goods and raise their price if these two types of goods are substitutes. Thus, a tariff on imports will reduce the price of exports relative to non-traded goods and shift production away from exports. Also, tariffs on intermediate inputs used by exporters in the absence of well-functioning duty drawback schemes increase the cost of producing goods for export and therefore, will reduce output of tradable goods. Tariffs on intermediates are of central importance to successful participation in regional and global value chains. It is also important to address non-tariff measures (NTMs) as part of a diversification strategy. Rules and regulations in overseas markets governing issues such as border procedures, technical regulations and standards can raise trade costs and limit entry by new exporters, especially when they are designed and/or implemented in a way that discriminates against trade. Lack of information and uncertainty regarding export-related requirements for exporting can undermine the survival rates of exporting firms. Standards can facilitate exports, and product upgrading, by codifying the requirements that are necessary to export to markets where demands for health, safety and for quality differ from the domestic market. NTMs that limit imports to the domestic market can also undermine exports by limiting competition among suppliers of key inputs and therefore access to new technologies. The WTO provides needed disciplines on

discriminatory regulatory measures and a forum for challenging regulations that arbitrarily discriminate against suppliers through the TBT Agreement and non-science-based food safety, animal and plant health measures through the SPS Agreement.

More recently, the WTO Trade Facilitation Agreement provides a mechanism for the global adoption of best practices regarding customs procedures as well as a forum to challenge discriminatory practices. Preferential trade agreements that include provisions for harmonisation or mutual recognition of product standards can also help reduce the costs associated with regulatory diversity and support diversification. Services trade policies can spur diversification through the expansion of services exports. They can also promote the diversification of goods exports through improved access to a wider range of more efficiently produced services inputs. High costs for energy, telecoms, logistics, and finance, erode firms' competitiveness and deter them from diversifying production and exports. As countries develop, service sector liberalisation can help firms to meet supply requirements, diversify, and integrate into global value chains in goods and services markets alike. Efficient services are also crucial for taking advantage of modern distribution channels. For example, producers are increasingly using e-commerce to sell directly to consumers through web-based outlets. However, diversification toward services exports can be hampered by regulatory diversity. Regulatory heterogeneity affects the fixed cost of entry into a new market as well as the variable costs of servicing that. To address this challenge, service sector reforms should go beyond trade openness by focusing on the simplification, harmonisation, approximation or mutual recognition of domestic regulations.

Competition policy

Competition policy plays an important role in the expansion of an efficient and diverse private sector and goes beyond implementing a legal framework for addressing dominant positions, collusion, unfair competition, and antitrust investigations to cover legal enforcement, competition advocacy and institutional effectiveness. Anti-competitive behaviour can seriously inhibit the scope and incentives to innovate and diversify (see Figure 5.4). Clear antitrust and competition laws and their effective and predictable enforcement are necessary to complement regulations that enable firm entry and rivalry. Left undetected, cartel agreements and abuse of dominant market positions can raise prices and discourage firms from investing in new or better products. Empirical evidence shows that on average, stronger market competition encourages innovation. In

addition to increasing firms' incentives for "process innovation", promoting competition also encourages "product innovation". Competition policy can also support "disruptive innovation", for example in service industries based on mobile technologies. Competition policy can enhance the impact of innovation programs on economic diversification. In Moldova, for example, the introduction of competition principles (transparent allocation criteria) into R&D incentive programs reduced the scope for selectivity bias toward connected firms, allowing less connected start-ups to access these programs. The application of rules that guarantee competitive neutrality in markets with state-owned enterprises can help firms to enter, expand and diversify based on their merits. By contrast, rules that discriminate against certain firms in favor of vested interests can hinder economic diversification. Lack of political will or institutional capacity constraints can limit the efficacy of competition policy reforms.

Competition policy can also play a key role in increasing the efficiency of domestic input supplying industries and support greater backward and forward linkages that foster diversification. Reforms that boost competition in input markets have spillovers on downstream firms. In many developing countries, input markets (such as fertiliser, cement, energy, finance and telecommunication markets), are often saddled with entry barriers and anticompetitive behaviour, due to economies of scale, network effects and the presence of state-owned enterprises. Fostering greater competition among service suppliers can prove especially important to lowering prices for consumers and producers alike. While a host of other factors – small scale, weaker collateralisation of intangible assets, inadequate access to finance, regulatory deficiencies – contribute to service sector inefficiencies, studies show that the pay-off from increased competition and efficiency could be large. Scaling up services trade provides double benefits: services exports represent a potentially important source of foreign exchange earnings that underpin diversification efforts. Meanwhile, services imports can lead to greater competition, lower prices and increase quality, enhancing efficiency gains and competitiveness in the process.

THE IMPERATIVE OF REDUCED TRADE COSTS

The single most important determinant of long-run trade growth is reducing the cost of getting goods to market – and securing inputs for local producers at lowest cost. For landlocked and small island economies, transportation costs inflate the costs of exporting and of sourcing inputs by up to 50 percent. While distance remains the most important source of trade costs, the lack of facilitation

at borders, the fragmentation of supply chains and limited access to affordable air cargo opportunities or land transport corridors all contribute to the high cost of trading across borders.

Investing in trade-related infrastructure, coordinated with relevant policy reforms and better governance, is key to help reduce trade costs and support more diversified trade. Estimates from nine Latin American countries suggest that a 10 per cent decline in average transport costs would be associated with an expansion of more than 10 per cent in the number of products exported (Moreira et al., 2008). In LDCs, the focus should be on ensuring that basic port, border and connecting transport infrastructure is in place. Best practices from trade and development projects implemented by the World Bank and other development partners show the importance of coordinating such infrastructure interventions with aid-for-trade support targeted at: (i) measures to simplify border procedures and improve the standards of treatment of traders and officials, including through training and other capacity building support; and, (ii) programs that address institutional weaknesses and governance failures among those ministries involved in trade issues and border clearance agencies, for example, by introducing performance based management of agencies operating at the border. Trade logistics services are a critical determinant of countries' connectivity to regional and global markets and their competitiveness. The importance of trade logistics has increased with the splitting up of production on a global scale and the increasing sensitivity of trade to transport and logistics costs. The decisions of firms on the country in which to locate, from which suppliers to buy, and which consumer markets to enter are all influenced by the quality of logistics. Thus, the cost, range and quality of logistics services available to exporters can define the scope for export diversification. For example, slow and costly logistics can prevent entry of otherwise competitive suppliers into just-in-time supply chains. Good trade logistics are crucial for the competitiveness of activities which rely upon imported inputs. Logistics performance remains an area where performance improvement can support the diversification priorities of developing countries. Available empirical evidence suggests that export concentration is often associated with poor logistics. A range of studies have indeed shown the importance of logistics for competitiveness and the development of the light manufacturing sectors that can drive diversification such as apparel, leather products and agribusiness. The trade logistics sector is often characterised by regulatory and institutional fragmentation and a lack of coordination that can be

just as costly to supply chains as direct transport costs. The sector provides a large set of activities which includes all modes of transportation services and a range of related ancillary services including freight forwarding, distribution, packaging, warehousing services, transport management services, and supply chain consulting services. Logistics services providers also require access to critical transport infrastructure (ports, airports, roads) in a non-discriminatory manner and are dependent on the time and cost of satisfying border procedures. This implies that logistics services are subject to many rules and regulations under the responsibility of different regulatory authorities, each with different regulatory objectives, and often with little coordination. Such fragmentation compromises the underlying network, increasing costs and reducing efficiency. It also aggravates the competitive disadvantage faced by some countries by virtue of their geographical position.

INTERVENTIONS THAT TARGET SPECIFIC MARKET, POLICY AND INSTITUTIONAL FAILURES

Effective government interventions to support economic diversification require a fluid dialogue and close coordination with the private sector – both domestic and foreign. Appropriate institutional arrangements are needed to elicit information from the private sector about potential opportunities for economic diversification; about existing bottlenecks that prevent a country from taking advantage of such opportunities; and about concrete actions and policies best able to remove such obstacles. Moreover, institutions must be able to cope with the challenge of sustaining interventions over time and coping with the risk of capture and rent-seeking often inherent in public-private interaction. As institutional capabilities vary greatly across countries, policymakers must be mindful of policies that match their existing capabilities. Types of government interventions that can support diversification include the following elements:

Export Promotion Agencies

Export promotion agencies and initiatives can address information failures that affect firm entry and survival in foreign markets. Low entry and/or low survival rates of exporting firms may result from information asymmetries such as difficulty in gaining information on product standards in destination markets. These can be mitigated when there is a greater presence of exporters of the same country operating in the same export markets or with more experience in

exporting the same products. When such information is not readily available, export promotion agencies can usefully fill the gap. These institutions can notably address information gaps for firms operating in non-traditional sectors, even if they are not yet exporters. However, export promotion agencies have a mixed record in promoting diversification. While some agencies have made strong contributions to the export performance of their sponsoring countries, such models are not always easily replicable. Evidence points to several features that contribute to successful export promotion. First, it works in policy environments that do not exhibit a strong bias against exports (such as an overvalued exchange rate or high tariffs that provide nominal and effective protection, or high trade costs). Special procedures, such as export processing zones or special export finance facilities, can shield exporters from poor trade policy environments but they may need to incorporate sunset clauses and reward rather than pick winners (Lederman et al., 2010). Second, export promotion agencies work best when they function autonomously, flexibly, and maintain open communication channels with private actors to support a demand-driven strategy. Third, export promotion activities are best financed through general revenues rather than through taxes on exports.

Investment promotion agencies

Investment policy and promotion efforts can support diversification by attracting greater volumes of foreign direct investment (FDI). Good practice is to refrain from using mandatory local content requirements; to promote policy coherence between FDI linkages to local firms and investment incentives, notably through well designed supplier development programs; and to provide a host of investor “after-care” services, including those targeted at anticipating possible sources of tension between host countries and foreign firms. Fewer procedural steps required to establish wholly foreign-owned, domestically-incorporated, companies, and fewer restrictions to the FDI arbitration process are associated with higher FDI stocks. International investment disciplines, particularly those embedded in PTAs, have been shown to increase FDI in participating countries. But restrictions on foreign acquisitions, discrimination in licensing, restrictions on the repatriation of earnings, and inadequate legal frameworks to appeal regulatory decisions can easily deter foreign investment.

Spatial Policies

Spatial Policies (SPs) can play an important role when growth is not regionally balanced and certain areas within countries lag behind (Moreira et al., 2013). SPs

involve policy interventions which aim to stimulate the economic development of specific locations within a country by attracting the emergence of productive and innovative firms. The key characteristics of SPs are that they: (i) target a specific area; (ii) are tailored to the specific context and history of a locality; (iii) aim to overcome coordination failures between different actors; and (iv) frequently involve stakeholders at the national and local levels in the assessment, design and implementation stages. These activities can be organised around four types of interventions: (i) growth poles; (ii) special economic zones; (iii) economic corridors; and (iv) clusters. Growth Poles emanate from a core location, where one or more critical industries or a group of firms are located. This core is frequently identified with a city or area where substantial agglomeration economies occur, allowing dynamic industries to exchange and diffuse new knowledge, innovation, share pools of skilled labour and infrastructure, all the while minimising the costs of providing public goods and services. In growth poles, strategic public investments in infrastructure can help to unleash the economic potential of selected locations and generate a catalytic effect on upstream and downstream industries. Additional economic activity, innovation and economic growth are subsequently expected to propel the economic dynamism of neighbouring areas through the diffusion of these activities. Special Economic Zones (SEZs) have been used to support diversification. SEZs are typically established to achieve one or more of the following aims: (i) attracting FDI; (ii) serving as “pressure valves” to alleviate large-scale unemployment; (iii) supporting a wider economic reform strategy; and, (iv) acting as experimental areas for the application of new policies and approaches (Farole, 2011). SEZs, such as export processing zones or industrial parks, typically offer a mix of financial incentives (e.g. tax breaks, subsidies), infrastructure facilities (e.g. uninterrupted electricity supply), trade facilitation (expedited customs procedures, duty free access to imported inputs), access to land, and protection from government interference, to induce a critical mass of private firms to enter, invest, and diversify economic activity. However, the empirical evidence on their effectiveness is mixed. SEZs have been successful when they attract investment that exploits a key source of comparative advantage—typically low-cost labour in developing countries. For example, in addition to successful examples from China and Malaysia, economies such as the Dominican Republic, Honduras, Republic of Korea, Madagascar, Mauritius, Chinese Taipei and Vietnam have all seen a significant number of manufacturing jobs created through export processing zones. However, there is also a substantial literature of examples of failed special economic zones that did not generate new economic activity (Lederman and

Maloney, 2012). The success of SEZs requires a flexible approach that is not based solely on fiscal incentives, limited labor regulations and wage restraint but encompasses a broader approach to providing an effective business environment and building firm-level competitiveness, linkages with the domestic economy, innovation and social and environmental sustainability.

Economic Corridors are characterised by the connection of two economic centers through connective infrastructure. The aim of developing a corridor is to leverage and intensify the growth potential of the two nodes at each end of the corridor by promoting the agglomeration of economic activity between the two nodes, along the physical infrastructure connecting them.

Economic corridors may encompass several smaller nodes along the way and could, in certain cases, evolve into a branch shaped structure. Economic corridors can be subnational in nature (connecting to sub-regional hubs, such as the Sulawesi Economic Corridor in Indonesia), national or even international (such as the East-West Corridor connecting Myanmar, Thailand, Laos and Vietnam). Most corridors are multi-sectoral, although sector specific corridors, such as agriculture focused corridors, also exist. Specific policy interventions within an economic corridor approach typically encompass public and private investments. Crucial to the development of the corridor is the transport infrastructure investments – often multimodal – connecting the two economic nodes. Private sector investment projects, combined with trade and regulatory policy reforms to improve the overall business environment of the corridor either take place simultaneously to the development of the basic infrastructure or ensue shortly after. Furthermore, the development of sectoral development plans can help boost the competitiveness of specific industries located within the corridor.

POLICIES TO SUPPORT ADJUSTMENT

The labour market is often key to the adjustment process. The extent and speed with which labour moves between occupations, firms, industries and locations, as well as the size of the adjustment costs borne by adversely affected workers, is to a large extent determined by the functioning of the labour market. In general, investing in education and skills contributes positively to economic diversification – telling examples include the growth of India's software industry, the increased sophistication of China's exports as well as rising exports of business services from the Philippines (Agosin et al., 2012). However, high enrolment rates in secondary and tertiary education do not automatically translate into high-quality learning. Skills development depends on the quality of educational inputs and a

focus on learning outcomes. Secondary schools and universities may produce graduates with narrow skills or with specialisations in fields that are no longer in high demand. Alignment with labour market demand is critical to address skill mismatches and support economic diversification. Addressing such mismatches is proving particularly important as a determinant of digital uptake.

Improving public-private coordination is required to better identify the skills needed for current and future labour needs. Despite improvements in the overall level of education among workers over the past five decades, firms continue to struggle to find workers with the required skill-sets. Many countries have education and training systems that are not developing the kinds of skills needed by the private sector. These are the skills that allow firms to deliver the products and services demanded by the increasingly globalised markets in which they operate. Therefore, longer-term education and labour reform needs to be accompanied by improved systems for skills development, particularly vocational training. These systems need to be informed by the private sector so that they can deliver the range of skills that are relevant to evolving market demands and to the firms that have the potential to deliver growth and productivity gains in the near and medium term.

Gender inequalities act to undermine efforts to diversify. High levels of gender inequality are associated with lower levels of export and output diversification and the available evidence suggests that gender inequalities are a cause of low diversification (Kazandjian et al., 2016). Inequalities of opportunity, for example in education, constrain the pool of human capital upon which diversification can be driven. Discrimination that limits the volume and nature of labour force participation by women narrows the pool of talent from which employers can hire. It also limits the number of female entrepreneurs. Hence, identifying and addressing gender disparities and constraints in education, training, access to finance and information networks and in the labour market represent important elements of inclusive diversification strategies.

A well-functioning financial sector is a further key element to support diversification. Financial instruments, intermediaries, and markets can facilitate the trading, hedging, and pooling of risks that firms take when they opt to diversify. Deeper financial markets and the diversity of funding sources they offer support diversification into more complex goods and greater varieties. They do so by allowing firms to access long-term capital financing and by funding riskier investments. In Africa, for example, shallow financial sectors have been a major

obstacle in efforts to diversify economies, as firms become unduly reliant on a narrow range of risk-averse lenders, typically banks. Obstacles in the financial sphere include complex credit application procedures, lack of collateral, high lending costs, inadequate venture capital and non-bank sources of funding, and short maturities against the backdrop of low financial capability which prevent firms from accessing finance.

Policies that support innovation and entrepreneurship and the reallocation of resources to innovating firms can be important in supporting the move to a wider range of higher quality of goods and services. Investing in innovation increases firm capabilities, facilitating the adoption of new technologies that improve productivity and product quality. Both product and process innovation can help firms to diversify by reducing production costs and freeing up resources that could be redeployed into innovative activities.

CONCLUSION

Our final discussion of the diversification challenges and paths taken by a range of developing countries suggests that no single formula exists that can promote an orderly process of structural change able to enhance the resilience of economies to external shocks and provide citizens with the more productive employment opportunities they crave. Policy must always and everywhere adapt to the specific circumstances, differing geographies and endowments, and contrasted institutional, governance and implementation capacities of countries at differing levels of development. The success of diversification efforts ultimately depends on the mix, sequencing, and timing of investments, policy reforms and institution building, and on their consistency with the underlying assets and related comparative advantages of any given country. Investments in skills, infrastructure, institutions and governance quality (i.e. enhancing the transparency, accountability, and predictability of government decision-making) increase the likelihood of success of diversification but are in turn affected by the extent of diversification. While every country follows a different path to diversification, a number of common features are apparent from successful cases of sustained trade-led structural change. The experience of several countries suggests the following are important drivers of successful diversification efforts: (i) a broad level of political commitment within government and societal support towards the goals of economic development, poverty reduction and social stability; (ii) a focus on export growth, FDI attraction and on increasing the range

of goods and services exported; (iii) the importance of a strong, technically capable administration to manage the diversification process; (iv) the presence of influential stakeholders with interests in non-mineral exportable sectors, to offset in part the political influence of the dominant sector(s); (v) the importance of building both human capital and institutional capacity (Gelb, 2010). In many instances, sustaining a diversification drive will require a multi-pronged approach targeted at stimulating exports of agricultural and manufacturing products and services. In most country settings, no single sector can (nor should) provide the necessary export growth on its own. Similarly, there are important and growing interdependencies between sectors, notably between services and manufacturing, that prevent any sector from growing too large without sufficiently competitive inputs from other sectors. While the current global environment creates daunting challenges for poor, small, landlocked and/or resource dependent countries, this chapter has shown that a range of diversification routes can be followed. For such routes to prove successful, however, policy attention needs to be paid to four key determinants of diversification strategies which development partners and International Organisations can support through targeted aid-for-trade interventions. These are: (i) the supply of appropriate incentive frameworks; (ii) investments and policy reforms targeted at reducing trade costs; (iii) effective policies to support adjustment and the reallocation of resources towards new activities; and (iv) government interventions directed at specific market, policy and institutional failures.