

# Area (d) of the Forum's Work Programme: Economic Diversification & Transformation

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**Joint SBI/SBSTA Forum on the Impact of the  
Implementation of Response Measures at SB38**

**June 4, 2013, Bonn**

# Overview

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- ▣ Mandate
- ▣ Defining vulnerability
- ▣ Reducing impacts
- ▣ Lowering exposure
- ▣ Concluding thoughts

# Mandate: Item (d)

**“Exchanging experience and discussion of opportunities for economic diversification and transformation”**

- Decision 8/CP.17 established Forum and work programme
- SB 37 and 38 are charged with implementing that work programme
- SB 39 will review the work of the Forum, providing recommendations

# Defining vulnerability

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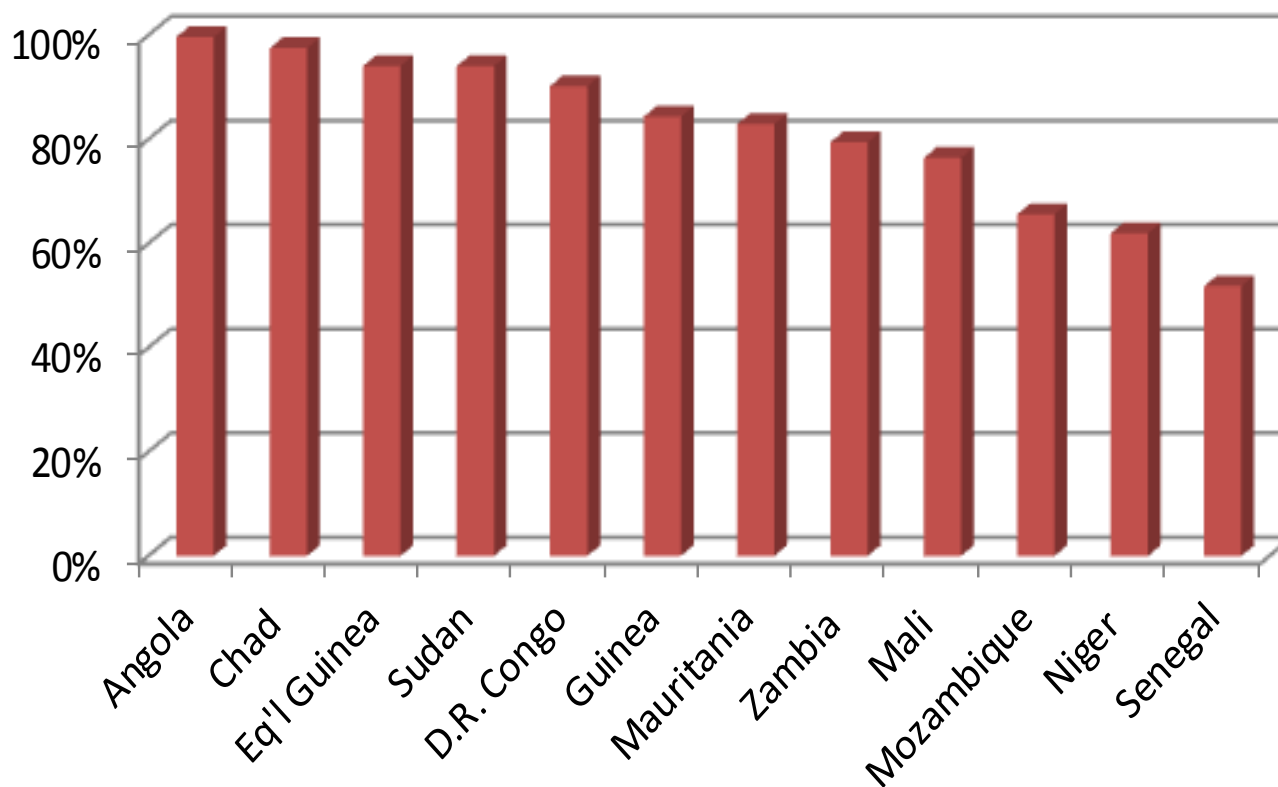
- Which countries are vulnerable to the impacts of response measures, and can be helped via economic diversification?
- Two characteristics:
  - Significant percentage of exports concentrated in few goods
  - Demand for those goods likely to drop as a result of response measures

# Characteristic I: Narrow Export Profile

- In 1980, 75% of developing country exports = commodities
- Current share of manufactures in goods exports:
  - Low-income countries: 56% (2007)
  - Lower-middle income countries: 44% (2011)
- But progress is uneven: particularly tough for extractives exporters

## Extractive Commodity Dependence, Sub-Saharan Africa

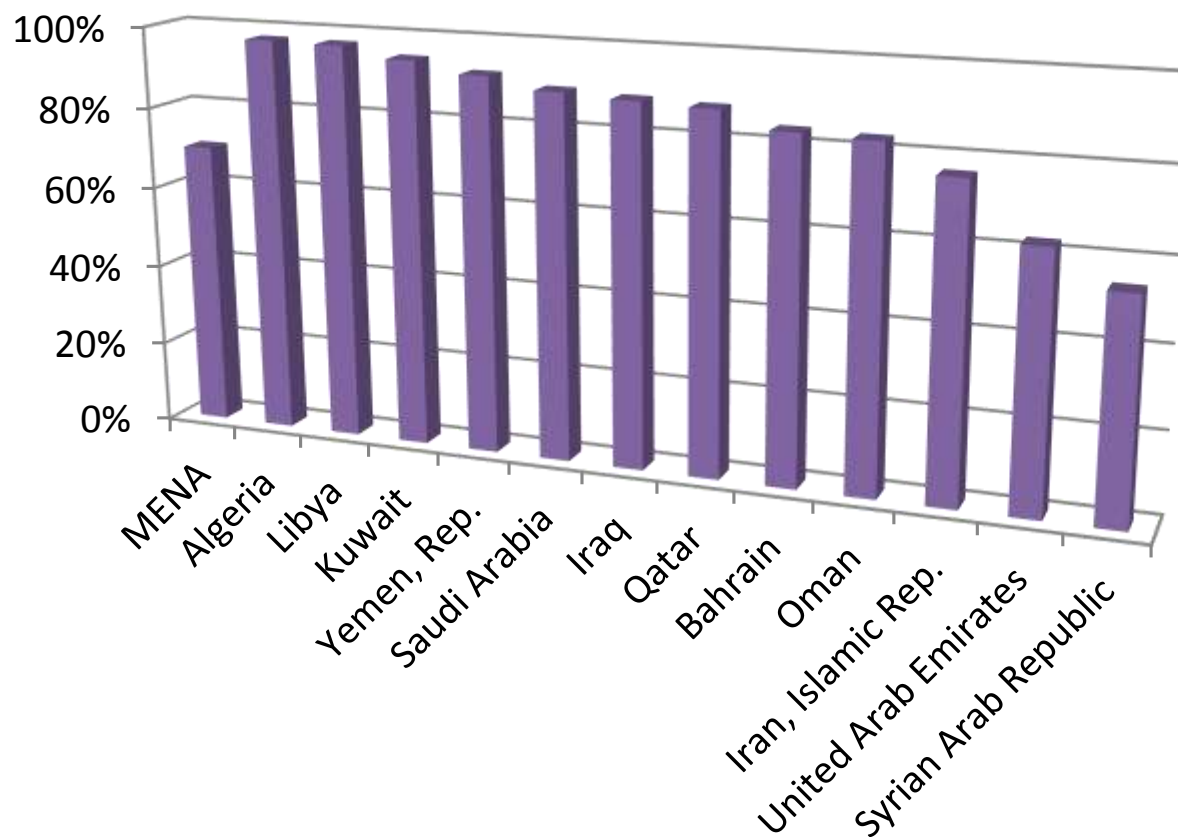
African LDCs with Extractives >50% of Exports



**Source:** International Trade Centre data; year = 2008.

## Fuel export dependence, MENA

### Fuel exports as % of merch. exports (avg. 2002 - 2011)



**Source:** World Development Indicators Database

# What does the commodity dependence literature tell us?

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- Empirically, some types of policies are successful in blunting the impacts of price shocks:
  - Flexible exchange rates (avoid dollarization)
  - Prudent fiscal management
  - Create strong external position



# Criterion 2: Vulnerability to Response Measures

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- Commodity dependence alone is not the problem (ag exporters are not vulnerable)
- Which sectors are in fact vulnerable?
- Need to ask what types of response measures are likely?

# Selected response measures and their impacts

Likely Policies	Key Impacts
domestic carbon taxes, cap & trade	loss of market share for foreign exporters of conventional fuels
subsidies to renewable energy tech producers	lost market share for foreign competitors (renewable energy tech and conventional fuels)
standards & labelling requirements	possible loss of market share for producing firms
border carbon adjustment	loss of market share for foreign exporters in EITE sectors
international carbon taxes or levies	on aviation – loss of tourism revenues for airline destinations; loss of market share for air freighted goods
	on maritime transport – reduced trade flows

**Source:** adapted from UNFCCC (2009)

# Export sectors likely to be impacted

- ▣ Conventional fuels: oil, gas and coal
- ▣ Renewable energy technologies
- ▣ Consumer goods subject to eco-labelling and standards
- ▣ Energy-intensive trade-exposed goods (aluminum, iron & steel, cement, chemicals, pulp & paper)
- ▣ Air-freighted goods
- ▣ Tourism
- ▣ Marine transported goods

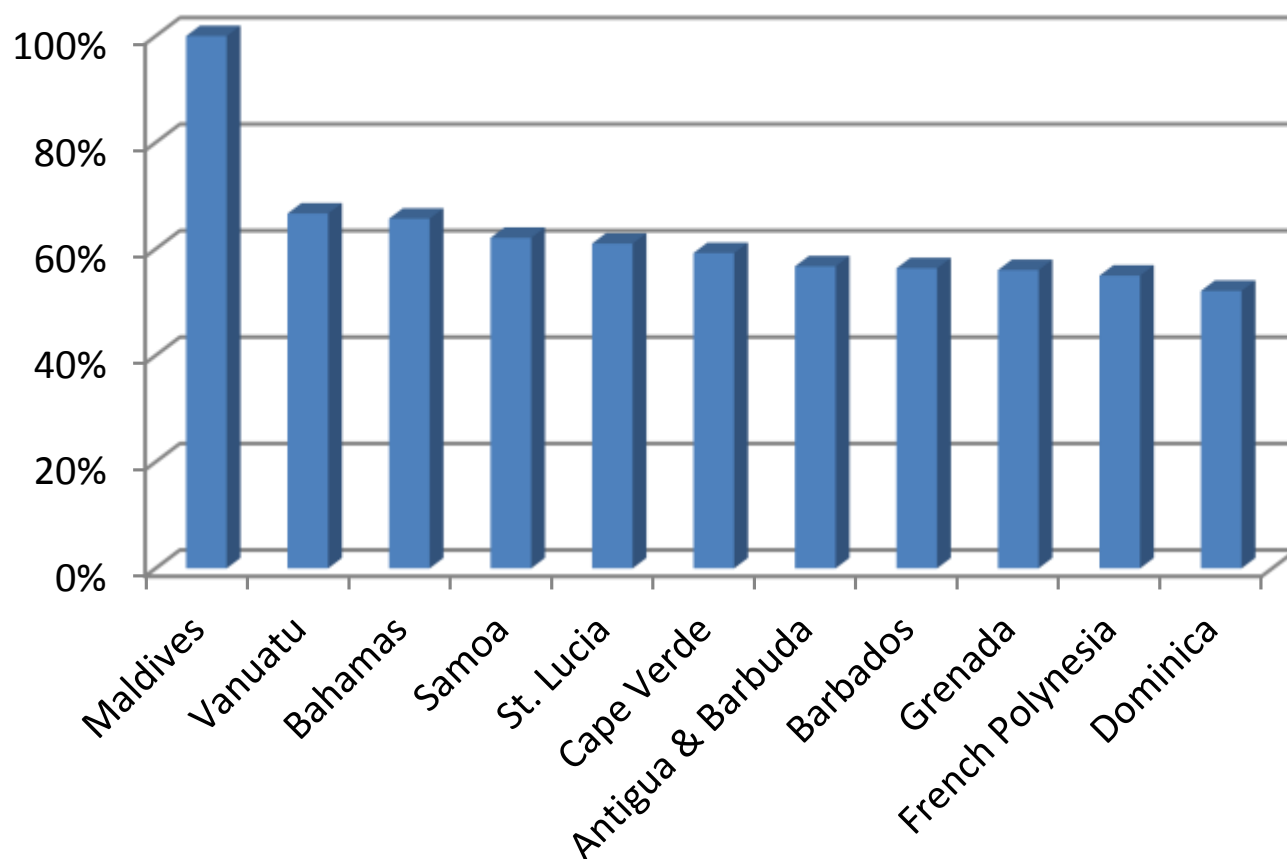
# But which are also subject to over-dependence?

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- Conventional fuels: oil, gas and coal
- Energy-intensive trade-exposed goods (aluminum, iron & steel, cement, chemicals, pulp & paper)
- Tourism

## Over-dependence, tourism exports

### Tourism as a % of total exports (average, 2005 - 2011)



**Source:** World Development Indicators Database

# What can the resource curse literature tell us?

- **Volatility:** particular problem for oil exporters, but may also be for tourism. Address with fiscal policy: well-designed stabilization funds.
- **Dutch disease:** tax dominant sector and distribute in ways that make other tradables sectors more competitive: infrastructure, education, research & development

# Lowering Exposure

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- How to actually achieve diversification? This is industrial policy.
- Industrial policy's recent redemption: from assuming it can't work to trying to find the right policy mix in each case to make it work.

# Three levels of industrial policy

## **1. Fixing the macro policies: get the investment conditions right:**

- ▣ Remove subsidies
- ▣ Use fiscal policy as stabilizer
- ▣ Keep inflation low
- ▣ Exchange rate that works for exporters

## **2. Addressing market failures of underinvestment**

- ▣ Transportation infrastructure
- ▣ Energy infrastructure
- ▣ Education
- ▣ Environmental protection

## **3. Targeted support: unleashing latent comparative advantage**

- ▣ Subsidies (tax preferences, grants, low-interest loans, etc.)
- ▣ R&D support
- ▣ Demonstration projects



# Industrial Policy: What we know

1. Remove policy, institutional, and cost elements in the value chain that limit production and exports (e.g., perverse subsidies)
2. Transparency: Quantify amounts in budget to parliament
3. Incentives/subsidies: Should be provided only to “new” activities – the real target for support
4. Objectives should be clear: established benchmarks/criteria for success and failure
5. Sunset clause: phase out subsidies and other support automatically
6. Projects should entail *private risk* commensurate with *public risks*
7. Competition: Avoid raising barriers to entry and import competition
8. Agency administering IPRs must have demonstrated competence, clear political oversight and accountability
9. Ministry should maintain channels of communication with the private sector
10. Evaluations: regular ex post external evaluation for firms

# Concluding thoughts

- To be successful, economic diversification must be part of a broader process of sustainable development
- Need at the outset to delineate the problem: What sectors? What states?
- No cookie cutter solutions: create country-specific blueprints for action
- Collaborate with institutions with expertise in this area (ITC, UNIDO, UNCTAD, IMF, World Bank)

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