Toward Export Diversification:
Trade and Industrial Policy Environment in Asian LDCs

Joint Policy Brief Issue 2- June 2008

Economic Institute of Cambodia and
UNDP Regional Centre in Colombo
[Asia-Pacific Trade and Investment Initiative]

When countries enter into export-driven industrialization, often the first commodities they produce are labour-intensive, non-durable products, such as textiles and garments. Lack of foreign exchange and access to credit can limit the volume of industrial capitals in the countries. A large reserve army of labour contributes to keep the average wage level low. Growth of the labour-intensive sectors has been a stepping stone towards economic development in Asia as the success cases of East and Southeast Asian countries illustrate.

Some Asian LDCs have already joined this development path. Labour-intensive sectors such as ready-made garments have been providing a regular income to millions, especially women with no or little education, who would otherwise still be excluded from participating in income-generating activities. Many of them send part of their income to their families in rural areas. A majority of the remittances are used to purchase of basic necessities and agricultural inputs, for education fees for siblings, and repayment of debts by their families. Although remittances from migrants in abroad have been regarded by some as a key to poverty reduction, job creation in home countries brings other benefits. For example, the indirect jobs are also created near the factories as the demand for housing, services, dining, and transportation arises with the number of manufacutring jobs created.

With the end of quota-based trade on textiles and clothing, the LDC exporters of these products are in need of export diversification so as to reduce the negative impacts generated by trade liberalization, if any. Diversification also has a positive impact on the economic growth. A cross-country study shows that export diversification is positively associated with the growth in per capita GDP (Raihan 2007). Diversification of industry portfolios that leads to job growth should be of particular interest to countries where there is a high demand for job creation.

Prospects for export diversification

A series of studies in Bangladesh, Cambodia, Lao PDR and Nepal, commissioned by UNDP, have identified the production of specific goods and services, which will not only enhance export potential but which will also have high human development benefits. Selection of sectors were based on the following criteria: revealed comparative advantage; export prospects and their sustainability; use of local inputs; and potential for creating employment, particularly for women and other disadvantaged segments of the society. Use of local inputs is important for creating backward linkages and higher value-added in the economy. Employment creation, especially in rural areas, is crucial in the view of human development and sustainable development. The selected sectors which are common among these four countries are food processing, handicrafts, herbs and herbal products, and tourism.

Given their richness in biodiversity and the climatic conditions, these countries have a great potential for producing high-value added products such as organic products and herbal extracts or medicinal plants. Cultural diversity in these countries also provides an enriched variety of handicrafts in materials and design. Many of these products are unique to their locality and may be eligible for Geographical Indication protection, which can result in higher premiums to producers. Having a number of the World Heritage sites, national parks and cultural heritage, these countries have a great potential to pursue tourism for sustainable development. Tourism can also provide markets for handicrafts and processed food as souvenirs or to be consumed at hotels and restaurants.

For better industrial policy environment: Issues and policy options for Asian LDCs

One of the main factors in determining the prospect of increased exports as well as investment from both domestic and foreign investors is the socio-economic environment that influences returns from investment. Macro-economic instability, poor infrastructural facilities, and deteriorating law and order are a few examples, which can hamper the profitability of investment. Better trade and an improved industrial policy environment for businesses, especially for small and medium enterprises (SMEs) in rural areas, is essential to export diversification for sustainable development. Major structural barriers and supply-side constraints need to be removed.

Common supply-side constraints which Bangladesh, Cambodia, Nepal, and Lao PDR have thus far confronted are; lack of access to finance; poor infrastructure; lack of trade facilitation measures; shortage of skilled workers; and lack of standards and certifications. Issues as well as policy suggestions will be summarized below.

Enhancing access to finance

Access to credit has been identified as a critical factor affecting business operation and expansion in these four countries. Lack of access to finance also hinders the prospect of accessing better technology, which may eventually result in reduced productivities of firms and industries. The problem is severe particularly for the SMEs, including those in the export-oriented sectors. High interest rates and a lack of collateral in the form of land and buildings for advancing loans are found to be bottlenecks for SMEs trying to access formal credit channels.

Banks are hesitant or unwilling to lend to SMEs as they do not consider them to be attractive and profitable undertakings. A number of micro-finance institutions (MFIs) have provided small loans to SMEs and farmers but their interest rates are often higher than commercial banks partly due to the high operation costs of MFIs.

In the case of Cambodia, the interest rates charged by MFIs are 3-3.5 percent per month – very high by international standards and relative to business profitability in rural areas (EIC 2007). Most MFIs have failed to raise resources locally; as a result, MFIs depend on funding from overseas banks. An increase in local saving and deposits for MFIs is crucial for the sustainable financing of small enterprises in Cambodia. Promotion of savings and deposit accounts and diversification of saving and deposit options are possible tools to increase local funding at MFIs.

SME's enhanced access to loans from commercial banks should be achieved. Development of an effective SME financial reporting system and a credit information sharing system can assist the goal. Sound monetary policy is a key for the LDCs to keep inflation rate – and thus interest rates – low.

Better infrastructure

Weak physical infrastructure appears to plague trade and industrial development in Bangladesh, Cambodia, Lao PDR and Nepal. Proper infrastructure and reliable services are vital for connecting all the players along the value chain and ensuring a smooth delivery of the final goods to the markets. Investment in roads, railways, waterways, ports, telecommunications and basic utility services such as electricity and water will assist industries to improve their competitiveness by cutting lead time and production costs.

A survey shows that utilities account for significant share of the total production costs of the manufactured goods (EIC 2007). The recent fuel price hike is likely to diminish cost competitiveness further at various stages of the value chain, such as processing

and transportation, in these countries. In addition to enhanced access to services, supply of reliable services is vital as power interruptions and quality of telecommunications are serious problems in LDCs. Maintenance of the existing infrastructure should also be strengthened. Private sector participation into this investment can be yet other effective policy measures.

Improved trade facilitation measures

Cumbersome administrative procedures and requirement of trade documentation by government agencies increase the cost of doing business significantly and weaken the competitiveness of the exporting firms. These obstacles take various forms. such as licensing, inspection and customs regulations.

Table 1 compares the costs and procedures involved in trade for selected Asian countries with the sub-regional average. Lao PDR and Nepal, both landlocked LDCs, perform poorly in all categories compared to the sub-regional average, particularly in the costs and time involved in trade. For example, the time and cost required in Lao PDR to export and import goods are double the sub-regional average.

Cambodia seems competitive in terms of costs of export or import procedures, but more documents and time are required to complete trade procedures than in neighboring countries, e.g., Viet Nam. In most of categories, Bangladesh is performing better than the sub-regional average. However, in comparison with a competitor in the region, Bangladesh is lagging behind the India – its biggest competitor in the region – in number of days required for export and import.

Reforms in the government administration in trade matters, licensing, and custom procedures are needed urgently to improve trade facilitation in these LDCs. Involvement of all stakeholders, including the private sector, in this process is a key to success.

Investment in human development

Despite having an abundance of labour, a shortage of skilled workers is a major constraint in the new startup and expansion of the manufacturing and service sectors in many LDCs. When export diversification and increased backward linkages are of high priority, as in the cases of the LDCs under consideration, such goals can be preconditioned by the limited availability of a skilled workforce in all levels ranging from management to specialized work.

A certain level of formal educational attainment and job-specific training and experience are essential for skill formation. Therefore, both quality general education and vocational and technical training suitable to the export diversification needs are required. While the improvements in the standard of education may require long-term planning and investment, various short- to medium-term vocational and technical training programmers can be provided through public-private partnerships. Empowerment of rural populations, women and other disadvantaged segments of the society involved in the production of exportable goods and services is also indispensable for sustainable development.

Table 1 **The costs and procedures involved in trade.**

Region or Economy	Documents for export (number)	Time for export (days)	Cost to export (US$ per container)	Documents for import (number)	Time for import (days)	Cost to import (US$ per container)
E. Asia & Pacific	**6.9**	**24.5**	**885**	**7.5**	**25.8**	**1,015**
Cambodia	11	37	722	11	46	852
Lao PDR	9	50	1,750	10	50	1,930
Viet Nam	*6*	*24*	*669*	*8*	*23*	*881*
South Asia	**8.6**	**32.5**	**1,180**	**9.1**	**32.1**	**1,418**
Bangladesh	7	28	844	9	32	1,148
Nepal	9	43	1,600	10	35	1,725
India	*8*	*18*	*820*	*9*	*21*	*910*

Source: World Bank. 2008.

Standards and certifications

Sales of organic food and textiles, herbs and herbal products, and cultural products such as handicrafts have expanded rapidly, especially in the markets of industrialized countries. Many producers are supplying the increasing competitive markets. Certification or designation as environmentally-friendly products or fair-traded goods is seen as means to create a niche market and add premium to such products. Standards and certification are useful measures to ensure the quality of goods and services. However, these system as well as other measures such as sanitary and phytosanitary (SPS) measures can become barriers in exports when LDCs cannot meet requirements for international standards. To overcome these issues, technical and financial assistance should be provided in these LDCs so that producers and service providers, especially SMEs, are well informed about standards and certification processes and manage the quality assurance. The capacity of certifying agencies should be enhanced as well.

For products, which are derived from, or use local or indigenous knowledge in the production, the intellectual property over such knowledge may be an issue. This may be the case where products are sold without benefits accruing to the communities or groups that have supplied the local or indigenous knowledge. A mechanism that formally involves all legitimate stakeholders including community knowledge holders should be established to develop relevant policies and laws on intellectual property rights, biodiversity, and protection of local knowledge. In the case of products such as herbs, herbal medicines, and medicinal plants, there is also a need to expand the rights of local communities over forest resources management to maximize benefits for local harvesters and minimize illegal collection of resources.

The studies of Bangladesh, Cambodia, Lao PDR and Nepal have identified a number of sectors with significant export potential. Even at their currently underdeveloped status, these sectors are contributing to export earnings and generating employment opportunities in LDCs. Further development and expansion of these sectors, therefore, is likely to have a considerable positive impact on employment creation, poverty alleviation and human development. Though the country experiences suggest that there have been some efforts in providing assistance to the development of the labour-intensive sectors, a number of critical constraints continue to hinder the goal of export diversification. The respective governments and private sectors need to make concerted efforts to overcome these constraints.

References

Economic Institute of Cambodia (EIC). 2007. *Export Diversification and Value Addition for Human Development*. Phnom Penh: EIC. www.eicambodia.org

Raihan, Selim, Ratnakar Adhikari and Kamalesh Adhikari (eds.). 2007. *Export Diversification for Human Development in the Post-ATC Era: Perspectives from Asian LDCs*. Colombo: UNDP RCC. http://www.undprcc.lk/Publications/TRADE/Export_Diversification.pdf

Raihan, Selim. 2007. "Prospects for Export Diversification: A comparative analysis of experiences from four Asian LDCs," in Raihan, Adhikari and Adhikari (eds.) *Export Diversification for Human Development in the Post-ATC Era: Perspectives from Asian LDCs*. Colombo: UNDP RCC.

World Bank. 2008. *Doing Business 2008*. Washington D.C.: The World Bank. www.doingbusiness.org

i This policy brief is derived from Raihan, Adhikari and Adhikari (eds.) (2007). A series of the country studies was conducted under the project "Addressing the Impact of the Phasing Out of Textiles and Clothing Quotas on the Asian LDCs" by UNDP Asia-Pacific Regional Centre Colombo. This brief is prepared by Kakada Dourng and Yumiko Yamamoto. The editorial suggestions from Cecilia Oh, Alanna Jorde, and Bryn Gay and the layout design by Bronwyn Walker are noted with appreciation. Views expressed in this Brief do not necessarily reflect the views of UNDP and EIC.