



*Economic transformation:
a new approach to inclusive
growth*

#EconomicTransformation
@ODIdev
@EconTransform



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What is economic transformation?

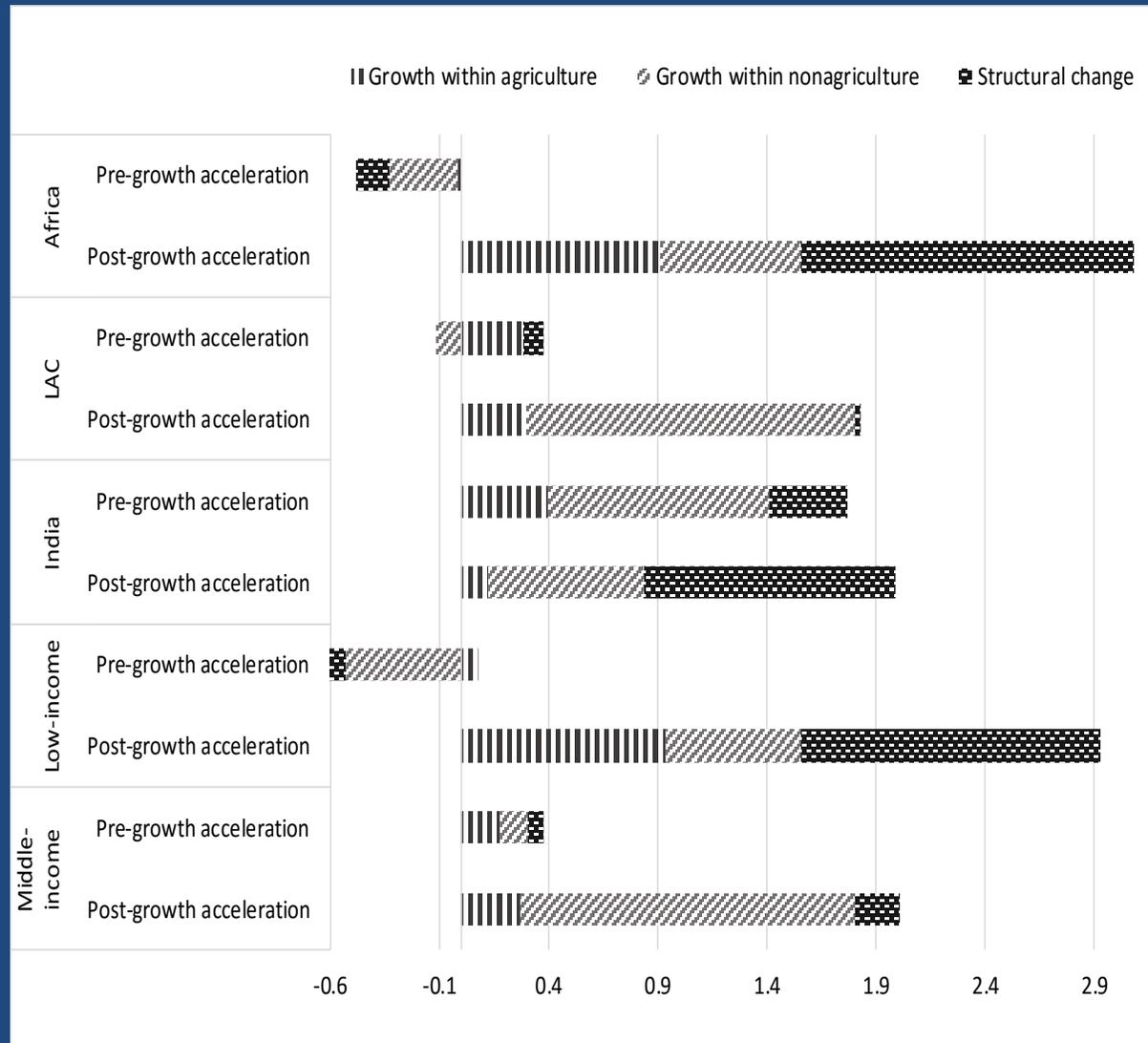
- **Broadly speaking it is the continuous process of closing the productivity gap across sectors and firms and between poor and rich countries**
 - **We typically focus on two mechanisms for closing these gaps:**
 - **(A) raising within-sector productivity growth either through shifting resources or by raising the productivity of existing activities**
 - **(B) moving labour and other resources from lower- to higher-productivity sectors (structural change)**
- Both are extremely important for achieving sustained growth in productivity*

Measuring economic transformation

- **Production based analytical measures to compute**
 - **Productivity (labor or total factor) and changes in productivity over time**
 - **Economy-wide level or sectoral level**
- **Trade based analytical measures to compute measures of**
 - **Trade competitiveness and changes in TC over time**
 - **Trade diversification and changes in TD over time**

Recent Evidence on Production Based Measure of ET

The Recent Growth Boom in Developing Countries: A Structural Change Perspective: Diao, McMillan and Rodrik (2017)



- SC plays important role in Africa and other Low Income Countries
- Within sector productivity growth is the driver in LAC and other middle income countries
- Within sector productivity growth outside agriculture very low in Africa

Why raising within-sector productivity is extremely important

- If it doesn't happen, structural change led growth will eventually peter out at a very low level of economy-wide productivity
- For example: Diao, Kweka and McMillan (2017) show that labor productivity growth in TZ has been very high but that is has been largely driven by expansion of the informal sector where average labor productivity is very low

Two strategies: same problem

Ethiopia

- Manufacturing firms in the formal sector are relatively unproductive
- Government has made attracting FDI a key pillar of its' industrial policy
- How successful is FDI at raising domestic firm productivity?

Tanzania

- 88% of employment growth in Tanzania has been in small relatively unproductive firms
- Small Industries Development Organization (SIDO) – public institution with mandate of increasing small firm productivity
- Is there a role for policies targeted at the most promising small firms?

Preview of results: Ethiopia

- Direct evidence of FDI/domestic firm links
- We find that opening a large FDI plant in Ethiopia is associated with the following outcomes for domestic firms:
 - TFP increases by 16%
 - Domestic firm entry increases by 53%
 - Domestic firms profits rise by 33%

Preview of results: Tanzania

- Enormous productive heterogeneity
- Characteristics of most productive firms :
 - Owner wouldn't quit for full time job
 - Firm hires paid workers
 - Owner has formal bank account
- Potential for raising productivity and employment growth in small firms by targeting financial and other products at these firms

INTEGRATING ECONOMICS & POLITICAL ECONOMY

- Prior assumptions about institutional needs of economic transformation are strictly limited to the importance of
 - Credible commitments to investors
 - Sufficient provision of public goods
 - Investment coordination
 - Information and learning costs for firms
- The conflicts between these requirements and the ways politics (and business) work in most developing countries are fully recognised
 - ... drawing on the best political science, not normative posturing

INTEGRATING ECONOMICS & POLITICAL ECONOMY

- Also recognised: the diversity of ways some developing countries have made headway in transformation despite these constraints
 - Island of effectiveness
 - Learning by doing
 - New forms of public-private collaboration
 - Role of ideas and demonstration effects
- Two essentials in external support for transformation:
 - Support **technically sound** public actions
 - **Politically smart** modes of delivery

TECHNICALLY SOUND AND POLITICALLY SMART

Typology of public actions to promote transformation

	Enabling interventions	Targeted interventions
To support structural change	Investment climate reforms Financial sector development Strengthening state-business relations	Export push policies Exchange rate protection Selective industrial policies Spatial industrial policies National development banks
To support within-sector productivity growth	Building fundamentals Investments in basic production knowledge <ul style="list-style-type: none"> • Managerial good practices as public goods • Agricultural innovations Promoting competition	Management training Attracting FDI Export diversification Developing global value chains Increasing agricultural productivity

Politically smart working

- Deep knowledge of context: choose your battles
- Focus on problems that domestic actors want to solve
- Be in a position to respond in critical junctures
- Don't neglect the role of ideas
- Look for friends in unexpected places
- Learn by doing



The SET approach to analysing economic transformation
Find out more: set.odi.org