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International Conference on Strengthening Integration of the Economies
in Transition into the World Economy through Economic Diversification

Geneva, 2-4 April 2008

**REPORT ON THE INTERNATIONAL CONFERENCE ON STRENGTHENING
INTEGRATION OF THE ECONOMIES IN TRANSITION INTO THE WORLD
ECONOMY
THROUGH ECONOMIC DIVERSIFICATION**

Summary

The International Conference on Strengthening Integration of the Economies in Transition into the World Economy through Economic Diversification addressed important policy-relevant issues on promoting economic diversification and further integration of the countries with economies in transition into the world economy. It was organized by the Committee on Economic Cooperation and Integration of the United Nations Economic Commission for Europe jointly with the Development Policy and Analysis Division of the United Nations Department of Economic and Social Affairs.

I. ATTENDANCE AND FORMAT

1. The International Conference on Strengthening Integration of the Economies in Transition into the World Economy through Economic Diversification took place from 2 to 4 April 2008. It was organized by the Committee on Economic Cooperation and Integration of the United Nations Economic Commission for Europe jointly with the Development Policy and Analysis Division of the United Nations Department of Economic and Social Affairs. More than 60 experts representing government bodies, academic institutions and non-governmental organizations from UNECE member States, the European Commission and intergovernmental agencies participated in the Conference. The meeting was attended by representatives of international organizations with activities relevant in the area of economic integration (United Nations Conference on Trade and Development, United Nations Development Programme, International Labour Organization, World Trade Organization (WTO), Organisation for Economic Co-operation and Development).

2. The discussions at the Conference were organised in seven thematic sessions. Each topic was introduced with presentations by leading experts in the corresponding thematic area (available on <http://www.unece.org/ceci/>). The thematic sessions were then followed by substantive round table discussion with the participation of high-level government and non-government experts from countries with economies in transition.

II. SESSION ON MOBILIZING INSTITUTIONS IN SUPPORT OF ECONOMIC DIVERSIFICATION AND INTEGRATION OF THE ECONOMIES IN TRANSITION INTO THE WORLD ECONOMY

3. Main issues addressed and discussed:

- (a) The countries with economies in transition are very diverse and there is no uniform policy that would suit all situations was general agreement on the importance to pursue policies conducive to economic growth which is a precondition for their integration into the world economy;
- (b) There were divergent views on the role of governments in the process of diversification. Many experts expressed the view that governments should not select sectors for their interventions. However, others favoured more activist approaches, with higher level of state intervention;
- (c) The existing market imperfections and failures create constraints for economic diversification. This is also an area where governments should take a more active stance to address such failures;
- (d) Resource-rich economies should seek both horizontal and vertical diversification to mitigate effects of Dutch disease. The resource-rich economies could start their efforts from diversifying the industries which they already developed and where they have comparative advantage. For example, instead of exporting raw materials, they could develop industries to process these commodities and thus increase the value added content of their exports. Developing some traditional sectors may also help export diversification; and

- (e) The experts shared their concrete experiences on the positive role of domestic institutions supporting policies of economic diversification (such as Investment and Export Promotion Agencies).

III. SESSION ON MIGRATION AND REMITTANCES: POLICIES IN SUPPORT OF ECONOMIC DIVERSIFICATION AND THEIR IMPACT ON DEVELOPMENT

4. Main issues addressed and discussed:

- (a) Remittances have a significant economic impact for the transition economies, in particular, for the disadvantaged part of the population in low income economies. However, there is evidence that in low income countries, a large share of remittances is used to finance consumption while relatively small amounts go to domestic investment;
- (b) The Russian Federation has become an important source of remittances to other countries of the Commonwealth of Independent States (CIS) in recent years, reflecting a rapid increase in the number of migrants from these countries;
- (c) There are serious statistical problems in measuring remittance figures, especially in some CIS countries;
- (d) The development of the banking system and access to banking services are important both for the reduction of transaction costs related to remittances, for their accurate measurement, and for combating money laundering;
- (e) Some experts expressed concern of possible “brain drain” related to the continuing high migration from countries with economies in transition; and
- (f) Another related concern was on the negative impact of remittances on domestic labour supply in recipient countries: there is evidence that many households receiving remittance choose to substitute labour for leisure.

IV. SESSION ON INTERNATIONAL TRADE AND ECONOMIC DIVERSIFICATION: THE POLICY CHALLENGE

5. Main issues addressed and discussed:

- (a) Different groups of countries show different patterns of trade performance. The South-East European countries largely replicate the Central European pattern with several years lag, with a gradual upgrading of the quality and skill structure of their exports. The CIS countries are still mostly specialized in commodity exports.
- (b) The regional free trade agreements among South-East European countries (in recent years, CEFTA) positively affected the diversification in their trade specialization;
- (c) Vertical diversification (upgrading into processing) requires well functioning linkages to differentiated customers in high income markets. Export-orientation strategies may help to achieve this objective. Countries should develop customer-oriented (demand driven) products and technologies and marketing know-how.
- (d) The extent and speed of diversification are also affected by the sophistication of the market to which the countries supply (domestic, international); and
- (e) There were divergent views on the role of the exchange rate regimes for the diversification of exports.

V. SESSION ON MARKET ACCESS FOR THE ECONOMIES IN TRANSITION AND MULTILATERAL TRADE LIBERALIZATION: HOW MUCH AND HOW FAST?

6. Main issues addressed and discussed:
- (a) The WTO accession process allows for considerable flexibility in countries' trade policies. Countries should try to reflect their preferences in the negotiation modalities;
 - (b) At the same time, WTO rules provide members with the possibility to apply safeguards with respect to candidates;
 - (c) Some speakers communicated a concrete request to the United Nations (UN) and its bodies to provide them with targeted assistance on their preparation for WTO accession and on the multilateral trading system;
 - (d) Some country experts expressed the view that there is no need to rush with the accession to WTO. Countries have to weigh short-term vs. long-term benefits and gains. Some support measures they are applying at present may be considered as protectionist measures by WTO. At the same time, they could concentrate on the negotiation of bilateral preferential trade agreements;
 - (e) There was widely shared view that good level of regional cooperation already exists among many CIS countries although some practical implementation issues continue to exist. As an example, EurAsEC member countries work towards deepening the cooperation among its members in areas such as: forming a common free market zone, including services, establishing a customs union, further cooperation in the real sector of economy, forming a common transport zone, creation of a common energy (power supply) zone, establishing a common financial market, further cooperation in the socio-humanitarian sphere; and
 - (f) Several experts presented evidence of the positive impacts of trade liberalization on trade and investment in their countries.

VI. SESSION ON ENHANCING ECONOMIC DIVERSIFICATION THROUGH FOREIGN DIRECT INVESTMENT AND THE ROLE OF INFRASTRUCTURE

7. Main issues addressed and discussed:
- (a) There was widely shared view that FDI has been one of the main channels of reintegrating countries with economies in transition in the world economy. FDI has been an agent of structural change in most new EU member countries;
 - (b) Countries differ in their FDI performance: while some countries successfully attracted large FDI, in others, the volume of FDI is modest, and its structural impact is less clear;
 - (c) Policy makers need to pay attention to factors that are key determinants of FDI, such as: institutional environment, transparency in public administration, efficient property rights enforcement; business risks associated with macro-economic policies, opening the privatization process to FDI, etc. However, in general, the relationship between the quantity and the quality of FDI is still not well understood;
 - (d) The spillover effects of FDI depend on a number of factors such as openness, well functioning labour markets, quality of local labour force, the absorptive capacity of

the domestic economy, entrepreneurship and bargaining power of the local enterprises, etc. These are also factors to be addressed by policy;

- (e) Efficient transport links and border crossings are important factors facilitating FDI, trade and economic diversification. There is a two-way relationship: the quality of logistics services attract FDI and facilitate international trade (by lowering transaction costs) (and vice versa, lengthy border procedures discourage trade); at the same time, increased FDI and international trade encourage quality logistics services;
- (f) Other related issues such as security concerns and prevention of illicit trades also need to be considered; and
- (g) National and international inter-agency coordination and cooperation is an important mechanism to promote efficient transport links and border crossing.

VII. SESSION ON ECONOMIC DIVERSIFICATION AND MODERNIZATION OF THE CIS: OPPORTUNITIES AND POLICY CHALLENGES; KEY DEVELOPMENT POLICIES

8. Main issues addressed and discussed:

- (a) Diversifying production and exports related to natural resources can be a good strategy to start with, as countries can benefit from comparative advantage they already have. For example, countries can develop services in natural resource related areas. In general, the development of the service sector is important in diversification strategies;
- (b) Continuing market-oriented reforms is a main precondition for diversification in both resource rich countries and in countries less endowed with natural resources;
- (c) For low income CIS countries, the development of the agricultural sector is a very important issue both for diversification and also in the light of poverty alleviation due to the large share of rural population;
- (d) The use of protectionist instruments to pursue diversification of domestic economies is not always a successful strategy (there is negative experience in Latin America). It is important to maintain a competitive domestic economic environment;
- (e) Diversification is also a development goal. A number of speakers shared the experiences of their countries (Albania, Armenia, Kyrgyzstan and Uzbekistan) in linking their diversification efforts with MDG goals; and
- (f) Pursuing development and diversification goals, countries should also seek to alleviate existing inequalities and prevent new ones from emerging. Some country experts provided evidence of important inequalities in economic opportunities as reflected by a pay gap between men and women in Central Asia. Moreover, in some countries these gaps have a tendency to widen further. Policy has an important role to play in reversing these trends.

VIII. SESSION ON DIVERSIFICATION THROUGH KNOWLEDGE-BASED DEVELOPMENT: POLICY CHALLENGES FOR ECONOMIES IN TRANSITION

9. Main issues addressed and discussed:

- (a) As part of the development process diversification implies the emergence of non-traditional in that economy sectors, industries, economic activities, products and services as well as greater integration in the world economy;
- (b) At present, given the dominance of the knowledge-based economy, diversification implies not just industrialization but mastery over knowledge-driven economic activity;
- (c) Diversification strategies call for an active public policy stance, in particular, the promotion of knowledge-centered economic activities;
- (d) Well-developed financial systems ease external financing constraints that impede firm and industrial expansion and facilitate faster adoption of new technologies and capital reallocation among sectors;
- (e) Knowledge-based development, which relies on intangible assets, requires a more developed financial system. In turn, financial development favours innovation as it improves the prospects of young firms; and
- (f) It is important to have efficient intermediation in all stages of the financing cycle.

IX. SUMMARY OF MAIN CONCLUSIONS AND RECOMMENDATIONS

10. General conclusions and recommendations:

- (a) There is a two-way relationship between diversification and integration: diversification is a means to achieve stronger integration, but also integration is a key means by which to achieve diversification;
- (b) Diversification and integration are not ends in themselves, but should be viewed as means to achieve a better economic performance. As such, diversification and integration strategies need to be part of an appropriate overall strategy for economic development;
- (c) Economic growth per se may not be sufficient to reduce poverty, so policy interventions may be required to make sure that economic growth is “pro poor”;
- (d) In some countries, there is a risk for a “feminization” of poverty, and women are particularly vulnerable to the risks associated with inadequate economic diversification. There may therefore be a need for development strategies to be made gender-sensitive to respect countrys’ international commitments to human rights but also to use women’s economic potential in mobilizing domestic resources for growth and reaching MDGs; and
- (e) The economies in transition are a quite heterogeneous group of countries in terms of population size, area, geography, economic development, resource endowments, sectoral structure, reform progress, political stability, degree of integration into the world economy. Therefore, policy recommendations regarding appropriate development strategies in general, and regarding diversification and integration strategies in particular, need to be tailored to the specific circumstances of each country.

11. Diversification strategies:

- (a) Exporting a broader range of goods with higher value-added must be the goal particularly for the smaller transition economies. However, for some of the larger

ones, significant diversification benefits may also be achievable in the domestic, non-traded sector;

- (b) Even in exporting, the focus should not be unduly restricted to diversification into or within the manufacturing sector, but there is also scope for diversifying into services exports (for instance finance, ICT-related services);
- (c) The goals of diversification should be to gradually move into more “high-tech” industries, but some also cautioned that it would be unrealistic for all transition economies to expect to become world leaders in high technology. Instead, some countries may have scope to diversify within the resource-based sector, either by expanding exports of some additional natural resources, or by developing services related to natural resources, or by developing processing activities;
- (d) For some transition economies, the challenge in diversification is not so much to move beyond a dependence on exports of natural resources, but more to move from low-intensity agriculture to a broader range of activities with higher value-added;
- (e) Some participants cautioned that in the past, some countries were ? have been economically successful without diversification, and that for some countries the only immediate alternative to a specialization in natural resources might be to compete in low-skilled labour-intensive industries, which is not necessarily a better niche;
- (f) In terms of appropriate policies, most participants agreed that it is preferable for policies to address market, coordination and system failures and to thereby improve the framework conditions for new and higher value-added economic activities to emerge, rather than to try to pick winners among industries;
- (g) Institutions are important for diversification and integration but the choice and design of institutions conducive to improving economic performance also depend on the specific context;
- (h) Weak institutions, by resulting in high transaction costs, may be an obstacle to diversification. They discourage economic activity, including foreign direct investment (FDI), in sectors where the country in question would have to compete with other countries whose institutions are superior. As a result, countries with weak institutions sustain economic activity and attract FDI primarily in sectors where they face little competition, such as natural resources;
- (i) Among the specific diversification policy instruments discussed were national development banks, government-sponsored venture capital funds, science parks, business incubators, policies promoting the commercialization of research and development (R&D), regional policy, policies that improve labour mobility and human capital, and policies that improve infrastructure (including transport, communications and energy infrastructure); and
- (j) In many of these areas, most notably in infrastructure, in the creation and management of science parks, business incubators and in the commercialization of R&D, there is substantial scope for public-private partnerships. Several participants argued that this was an area where capacity-building assistance from the UN would be particularly welcome and fruitful.

12. Integration strategies:

- (a) Multilateral integration initiatives (EU, WTO accession) can serve as “anchors” that promote institutional reforms at the national level. However, a lack of skilled negotiators may slow down accession processes or may force countries to decide

- whether to push bilateral agreements or to focus on multilateral agreements. Some participants invited the UN to help their countries build expertise in trade negotiations, particularly WTO accession negotiations;
- (b) Bilateral and regional integration initiatives, particularly in the CIS, have been hampered among other things due to a lack of national implementation, harmonization of national laws and regulations, coordination of customs policies, and due to high transport costs and different levels of economic development;
 - (c) Specific mechanisms for integration include export insurance agencies, export promotion policies, access to banking services. The United Nations could help with building-capacity in export promotion, particularly for small and medium-sized enterprises (SMEs), but also for government agencies (particularly non-fiscal measures of export promotion);
 - (d) Remittances are an important source of foreign capital, although there are large measurement problems and the overall magnitudes of the flows are often unclear. To prevent a brain drain, there may be a need for policies to make staying or returning home more attractive for talented people;
 - (e) Regarding FDI, policies should target raising a country's general attractiveness to foreign investors (rather than trying to attract specific types of FDI) and on maximizing positive spillovers from foreign subsidiaries to the domestic economy;
 - (f) Some countries are also increasingly engaging in outward FDI and exports of "high-tech" services, and this has happened without government support. The UN might help identifying and disseminating good practices on promoting outward FDI;
 - (g) In designing capacity-building and technical assistance programmes related to FDI, the UN should take on board advice and experience from the private sector;
 - (h) Regarding infrastructure, it was acknowledged that there are important bottlenecks that hamper both integration into the global economy and diversification of the national economy, and that require substantial investments (including through public-private partnerships (PPPs)). At the same time, some of the most crippling bottlenecks are not caused by inadequate physical infrastructure but by excessive regulation and by corruption. This is particularly the case with border-crossing procedures. Significant improvements in this area could be attained here at relatively small costs;
 - (i) The need for international cooperation on infrastructure development (but also on removing regulatory bottlenecks) is particularly acute for landlocked and transit countries;
 - (j) Security concerns were raised both in connection with easing border controls (drugs, arms) for goods and in connection with facilitating the transmission of remittances (money laundering, terrorism financing); and
 - (k) The requests for increased assistance from the international community included some concrete proposals, such as:
 - (i) assistance in raising financing to install modern equipment for customs;
 - (ii) expanding UNECE work on paperless customs procedures;
 - (iii) assistance in facilitating the issuance of Schengen visa for professional drivers;
 - (iv) assistance in increasing internet access and use of information and communication technologies (ICTs);
 - (v) creation of a network of cooperating trade research institutes;
 - (vi) assistance in capacity-building on the streamlining of customs procedures; and
 - (vii) assistance in capacity-building on the harmonization of trade laws.