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**From the Selected Works of Robert C. Shelburne**

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# New and Dynamic Sectors of World Trade

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## **UNCTAD Expert Meeting on New and Dynamic Sectors of World Trade**

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It is my understanding that the purpose of this meeting has been to assess the usefulness of the “new and dynamic goods” framework in providing information that can be used to:

- Evaluate the progress that the developing countries are making in integrating themselves into the world economy, especially into “desirable” sectors.
- Determine the role of South-South trade generally or Southern regional trade arrangements in promoting these sectors.
- Provide information that may be useful to government planners, entrepreneurs, and financial markets in determining how individual countries can benefit from becoming competitive in these sectors and what policies can be used to efficiently promote these sectors.

Generally I think that we have been far more successful in addressing the first two objectives than the last one. The focus of this meeting on the structure of exports is consistent with a more general re-focusing of trade theory toward the types of goods exported, with the underlying assumption being that it is better to export some goods than others. However, given that serious analysis and resources are being used to examine the product structure of developing countries’ trade, I wonder if the focus on new & dynamic products, as currently defined, is the most useful. There is nothing inherently good about new or dynamic products, per se. To the degree that they represent markets that can be easily entered or provide effective ways to increase employment, then the focus might be warranted. However there are other criteria such as products experiencing fast productivity growth, those with high value-added or those that pay high wages, or those associated with extensive employment creation, positive externalities or technological spillovers, that might be more worthwhile to examine. Nevertheless I think new & dynamic products may come close to being a proxy for some of these things, however in examining these products, I would tend to define them rather loosely so these other important considerations could be included in the analysis.

In this regard, the Hausmann-Klinger paper of yesterday (The evolution of comparative advantage in the product space: applications to the analysis of south-south trade) had as a basis the Hausmann-Hwang-Rodrik analysis concerning the income level of exports. According to their analysis those countries that export products which have a high value for this export index relative to their per capita income experience higher subsequent growth. Thus they have supposedly found some product characteristics that are empirically tied to something that we really care about, that being economic growth. So I would encourage UNCTAD to try to focus on product characteristics that have some proven relationship to desired outcomes. I bring this up as an example, but I might add that I have examined the ability of this index to predict economic growth going back to the 1970s,

instead of just more recent growth as they do, and found it to be of limited usefulness. Thus the robustness of this variable is probably less than what they allege.<sup>1</sup>

Next let me comment on the increasing importance of South-South trade. Given that GDP growth in the emerging markets & developing countries has been over 2.5 times faster than for the advanced economies over the last 7 or 8 years, and given that the well established pattern where the trade to GDP ratio increases with development, and given the liberalizations in the South, it would certainly be expected that trade growth in the South should have been rapid and should account for an increasing percentage of world trade. Thus as a general point, I think these recent trends reflect long established patterns and are not indicative of any fundamental change in the structure of the world economy, other than the fact that the South has been growing economically quite rapidly. This is not to say that there are no fundamental changes occurring in the world economy, the increasing fragmentation of production is certainly one.

One of the basic questions that has been raised is whether this South-South trade is fundamentally different, or better or worse than North-South trade, or is it just more trade. One of the conclusions of yesterday was that South-South trade contained a higher proportion of dynamic products, and by implication this suggested that these trade flows were perhaps somehow to be preferred from a development perspective. However, I think there is some circular reasoning here. If the growth of trade is primarily South-South due to their higher economic growth, then those products traded amongst the South will generally be found to be the more fast-growing products, and thus it's almost a logical necessity that South-South trade would contain a higher proportion of dynamic products. In a number of ways, I find the evidence, in the studies presented, suggestive that exports to the North remain more important in terms of providing a basis for diversification and growth, especially of sophisticated products. However, this also requires more analysis.

A basic question that I do not think has been sufficiently answered is whether South-South trade is providing countries a testing ground or a stepping-stone for developing a comparative advantage in new industries, much as a domestic market provides for a large country. Once established in other Southern markets are these exporters then able to compete globally, or is their competitiveness due to some form of preferential treatment that does not ultimately translate into global competitiveness, and in the short-run may even imposes trade diversion costs on its trading partners. More specifically, large countries appear to have some advantage in moving into desirable export sectors, the question is whether Southern regional trading arrangements give small countries a similar advantage. It would appear that the Hausmann-Hwang-Rodrik "costs of discovery" framework would suggest that they may not, since factor costs, regulations, infrastructure and other variables would still be different in different countries within the bloc and the information discovered by one entrepreneur would not transfer across borders. Nevertheless a larger market might allow some additional producers in the domestic market of the original entrepreneur.

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<sup>1</sup> Robert C. Shelburne and Oksana Pidufala, [Evolving Trade Patterns in the CIS: The Role of Manufacturing](#), UNECE Discussion Paper No. 2006.2, September 2006. Presented at the International Trade and Finance Association conference, University of Lodz, Poland, May 2006, and at the European Trade Study Group, University of Vienna, September 2006, and at the UNCTAD trade seminar series, October 2006.

I might just mention quickly some of my own research along these lines. I have examined the export structure of the CIS economies, this is a working paper on the ECE website ([www.unece.org](http://www.unece.org)) if anyone is interested. I have looked at this Hausman-Hwang-Rodrik (H-H-R) income level of exports for these economies, and found that the CIS economies export a much better set of products (as defined by H-H-R) to the other CIS members than they do to the rest of the world. An unanswered question is, whether these exports of sophisticated products to the other CIS are allowing them to develop industries which will ultimately become globally competitive, or if these industries will ultimately die out as the CIS economies further open their markets to world competition.

In addition, I have examined the introduction of new products into the export baskets of these economies at the HS 6-digit level. I have found two important things. 1) There is tremendous turnover of products in their export baskets. This is consistent with the “entrepreneurial gamble” analysis discussed earlier by Professor Cadot. For example, take Armenian exports between only four years 2000 to 2004. After only 4 years, over one-third of the manufactured items initially in its export basket in 2000 were not longer being exported; and due to the introduction of new items, less than one-half of exported manufactured items in 2004 had been exported only four years before. The second thing I found was that the quality of the new products that entered their export basket was generally no better than the quality of the items that were dropped (using the H-H-R criteria). Thus in the discussion of new products, it is important to also consider what is being deleted since the new ones may be no better than the old ones. Analysis of this issue regarding the degree to which South-South trade provides a platform to future global competitiveness requires a more dynamic type of analysis, which I would suggest, UNCTAD should pursue.

Another aspect of the analysis presented here has been its almost sole focus on trade. Yet underlying exports is a production structure. Often the analysis appears to have assumed that the decision to export and produce occur simultaneously and are one in the same, however in many cases, especially for large countries, firms develop a domestic market first and only begin to export goods after they are well established in the domestic market. This absence of a distinction between newly produced products and newly exported products may need to be more formally addressed. Along these lines, the fragmentation of production into smaller slices of the production process is making the use of trade data, which categorizes and values products on their latest state (or transformation) rather than on what was domestically added, more and more disconnected from what is actually happening on the ground. This is, of course, a problem facing all trade analysis.

Also along these lines, there is evidence that new firms make a disproportional contribution to GDP growth, employment creation, and productivity growth. However, it is less clear what the relationship is between new exports, new domestic production, and newly created firms.

In explaining the introduction of new products into export baskets, FDI is quite important. In the eastern European former transition economies foreign firms have really dominated export growth. Yet FDI has been hardly mentioned over the last two days. I would think this would be another important angle UNCTAD should pursue especially given its in-house expertise regarding FDI.

Several papers have found that export diversification promotes growth or is associated with growth. For me the question is whether it is diversification per se which is important such by maybe reducing volatility, or whether the new products countries diversify into are simply more conducive to productivity growth. I tend to favor the latter explanation and think it's primarily a case of just getting into manufacturing. Thus after countries have gotten largely into manufacturing, there is no longer an advantage to further diversification. The Cadot paper provided some interesting insights into the nature of diversification (intensive vs. extensive), but I didn't understand why country size was not controlled for when examining the number of export lines or the degree of diversification. Hummels-Klenow, for example, have also studied this issue and have found country size to be a significant factor that needs to be considered.

Let me now turn now to what we have learned about how individual countries can use this information to promote their development. First what is the role of the government promoting new dynamic sectors or diversification more generally? There are clearly market failures and externalities here, but do governments need to promote specific sectors or would a general development strategy of keeping an undervalued currency as suggested by Rodrik (The real exchange rate and economic growth: theory and evidence) or having a uniform protective tariff for all manufacturing as suggested by Greenwald-Stiglitz (Helping infant economies grow: foundations of trade policies for developing countries) or having an economy-wide subsidy for manufacturing be sufficient while avoiding all the rent-seeking problems associated with picking sectors. The pitfalls of having an industrial policy without a complementary set of high quality government institutions are well established. As I mentioned, although a number of country programs to promote diversification have been discussed at this meeting, including trade policy, industrial policies, infrastructure development, or investment policy, neither these countries nor anyone else have provided a real evaluation of the effectiveness of these interventions. Thus we have little useful advice to provide in helping countries design their policies. I would hope that as time proceeds, UNCTAD will be able to analyze these experiences and then be able to offer specific advice on what works and what does not work.

I think there has been a tendency to jump too quickly from a description of trends to a policy recommendation to implement some policy to duplicate these trends. It is one thing to observe that diversification accompanies growth, it's another thing to observe that more diversified economies grow faster, and yet another thing to suggest that diversification should be promoted, even when it is not natural, as a way to speed development. I'm not sure that these differences are fully appreciated. At the same time I'm not saying that policy action to change the direction of structural change is not warranted, but the consequences of implementing these policies need to be explicitly examined rather than just relying on the trends of successful economies.

Finally let me make a few other quick suggestions about UNCTAD work in this area. I have spent probably half of my working hours over my career in cleaning up datasets loaded with inconsistent data and missing values. I was therefore quite pleased to learn of the existence of the South-South Trade Information Database where all this dirty work has already been done. This would appear to me to be an important asset that will provide a real stimulus to research by lowering the fixed costs of entering this line of analysis. This is the type of activity that only an organization can undertake and maintain, as an academic is unlikely to devote such a large part of his career to such an endeavour. I would hope that the member states of UNCTAD would continue to support this activity. I

hope this data will be made freely available to researchers and even put on the web if possible. Incidentally, I don't understand why it is limited to the 4- digit level.

Secondly, let me follow up on the suggestion made yesterday by others that UNCTAD expand its involvement in collecting, disseminating and analyzing services trade data for the developing countries. Although the OECD is active in this area for its members, there is really no organization that attempts to do this for the developing countries. This is an area where information is really needed but is currently generally not available; it is also area of economic activity that is expanding quite rapidly in the South both in terms of domestic activity and in terms of its trade.