



EXPLAINING ECONOMIC TRANSFORMATION PATHWAYS

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Forenote on Sri Lanka.

This report was originally written in July 2021, since it's completion events in Sri Lanka have changed to a significant degree. In April 2022, Sri Lanka announced a pre-emptive default on its foreign debt obligations following the impact of external shocks such as the Covid-19 crisis and the start of the Russia-Ukraine war. This middle-income country with enviable social indicators is now experiencing rising poverty, hunger and political instability. A new government was appointed and the country is pursuing a \$2.9 billion IMF programme to address the challenges but is facing daunting debt restructuring with private creditors and China. Whilst the overall transformational pathway highlighted in the paper remains, readers should bear in mind the subsequent issues Sri Lanka has faced.

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LIST OF ACRONYMS

APEC	Asia-Pacific Economic Cooperation
ASEAN	Association of Southeast Asian Nations
BPM	business process management
ECI	Economic Complexity Index
EPZ	export processing zone
EU	European Union
FDI	foreign direct investment
GDP	gross domestic product
HCI	heavy and chemical industry
ICT	information and communication technology
ILO	International Labour Organization
IMF	International Monetary Fund
JOIN	Global Jobs Indicator Database
KOTRA	Korea Trade–Investment Promotion Agency
MFA	Multi-Fibre Arrangement
R&D	research and development
SET	Supporting Economic Transformation
SEZ	special economic zone
TVEs	township and village enterprises
US	United States
USAID	United States Agency for International Development
WDI	World Development Indicators
WESO	World Employment and Social Outlook
WTO	World Trade Organization

EXECUTIVE SUMMARY

Using empirically grounded case study examples, this paper seeks to understand the factors behind pathways of economic transformation. It first discusses conceptual issues behind these transformational pathways, based on the economic transformation literature, and to explain the driving forces behind transformational pathways. It then examines transformational pathways by looking across a range of comparator countries. The paper then synthesises the potential factors in the process of economic transformation and uses the information and data to build up a picture of the factors behind economic transformation. This has wider implications for how policies, institutions and their support organisations can best support economic transformation efforts.

The paper provides a conceptual framework of economic transformation. It then uses descriptive macroeconomic statistics to illustrate successful examples of economic transformation since the 1960s. It selects six countries that illustrate various aspects of economic transformation, including relatively recent transformers such as Bangladesh, China, Mauritius, South Korea, Sri Lanka and Vietnam. The analysis compares countries on several measures, using data from high-quality sources and with a 'developing country' average to indicate how these six countries have been successful transformers. The paper then proceeds to provide a more in-depth discussion of the conditions, drivers and triggers – both internal and external – that have influenced pathways of economic transformation.

The report argues that economic transformation is an iterative, long-term process that requires constant support, attention and change. It can be triggered by events and contextual factors but can also be a result of deliberate action. Pull and push factors that facilitate economic transformation for each country are country-specific. These factors are likely a combination of internal (e.g. government policy, internal conflict) and external (e.g. regional conflict, changes in trade agreements) issues pushing a country on its economic transformation pathway.

Even though these triggers, at the country level, are context-specific, the paper attempts to distil these to understand the potential common denominators in the countries that have exhibited economic transformation. These are broadly divided into three areas.

Triggers are the events that kick-start the transformative process:

- **Shock events:** Several economic transformation processes began as a result of what could be defined as 'shock events', which triggered changes in either political or economic circumstances, leading to a chain reaction within the country.
- **External influences:** Countries may begin the reform process by taking advantage of beneficial external conditions, or be influenced by external agents of change.
- **Planned change:** The process of reform may be triggered by deliberate political decisions that set a country out on the pathway to economic transformation, for example five-year development plans.

Enablers are the factors that sustain the transformative process:

- **Strong government:** The drive to reform a country requires a strong, capable, government with a capable civil service that can enact its development vision.
- **Capable civil servants:** A significant number of economic transformation processes have been successful thanks to strong capacity in government institutions – that is, to base policy choices on reputable knowledge and expertise.
- **State–business relations:** Ensuring that private enterprise is part of the reform process helps government support transformative sectors with growth potential.
- **Entrepreneurship:** The entrepreneurial capabilities of a country's private sector can influence its transformative trajectory.
- **Labour force:** The composition of a country's labour force can be an important driver of the economic transformation process.

- **Labour supply:** Transformative sectors require workers; initial stage transformative sectors such as lower-value manufacturing benefit from an existing abundant labour force.
- **Labour costs:** Lower labour costs attract foreign-direct investment in labour-intensive manufacturing sectors, promoting the growth of such sectors.
- **Labour skills:** Where labour is skilled, it can promote growth sectors.

Policy shapes the transformative process:

- **Policy support:** Government policy support is fundamental to promote the economic transformation process.
 - **General support:** Transformative countries give general public policy support to foster the economic transformation process.
 - **Targeted support:** Transformative countries have also made use of targeted public policy support to develop specific, transformative sectors within their economy.
- **Privatisation:** In parallel with internationalisation, most economic transformation reforms see a process of privatisation – particularly in centrally controlled countries.
- **Manufacturing:** All case study countries underwent economic transformation by promoting their manufacturing sector.
- **Internationalisation:** Case study countries exhibited one common trait – the internationalisation of their economy.
- **Education and research and development (R&D):** The countries that have continued to sustain economic transformation are those that have invested in their capability to innovate.

These triggers often work in conjunction (or sequenced). Pragmatism is important in order to control the pace and outcome of transformative change. As a part of the transformative process, the manufacturing sector is critical, but it is not the end game, and countries that have exhibited sustained transformation have moved not just from agriculture into manufacturing but also into high-value services. However, manufacturing plays a critical role in kickstarting and supporting this process. Expertise in government is fundamental to promote change that is not diluted by ineffective politics, as well as an understanding that long-term economic transformation relies on building up local labour force skills, education levels and R&D capabilities. Meanwhile, not all forms of economic transformation result in robust economic systems. For example, Bangladesh's reliance on garments makes it vulnerable to economic shocks.

Finally, the paper finds that **sequencing matters**. The case study countries show that transformation occurs through a sequence of events. The process usually begins with a 'shock' that alters the in-country dynamics, allowing more progressive governments to begin a planning process, accompanied by a strengthening of government capabilities and laying down the foundations for a more competitive labour force (education, skills). Countries initially targeted export-oriented manufacturing through small-scale initiative such as special economic zones, later scaled up to the national level. In parallel, the foundations for future growth were laid through business environment reforms, the organisation of effective state–business relations and long-sighted investments in R&D. These bases, combined with government adaptability, were fundamental to high-growth countries sustaining the transformation process, as they made it possible to move into high-technology goods and high-value services.

1. INTRODUCTION

It is now well understood that developing countries that have achieved higher growth rates have moved from relatively less productive agricultural activities into higher-productivity manufacturing and services activities. This shift has been particularly evident in developing countries in Asia. The lessons from these countries could help promote growth, through transformational shifts, in low-income countries.

While previous economic transformation analysis has highlighted what these transformational pathways look like, providing evidence that the increased allocation of resources to more productive activities does result in higher growth rates and, more importantly, better employment opportunities in developing countries, it is less well known how and why such shifts have happened over time.

Using empirical analysis in a range of country case studies, this paper seeks to understand the factors that have influenced economic transformation. It first provides a conceptual framework of economic transformation, which provides the underlying basis for the remainder of the discussion. It then uses descriptive macroeconomic statistics to illustrate successful examples of economic transformation that have occurred since the 1960s.

Based on analysis of relevant indicators, the paper selects six countries to illustrate how economic transformation has occurred in the past. These are relatively recent transformers: Bangladesh, China, Mauritius, South Korea, Sri Lanka and Vietnam. The analysis compares the countries across a number of relevant metrics, using data from well-known sources such as the World Bank's World Development Indicator database, and also with the 'developing country' average to indicate how these six countries have diverged. The paper then proceeds to provide a more in-depth discussion of the conditions, both internal (e.g. government policies) and external (e.g. international trade agreements), that have influenced the countries' transformational trajectory. We analyse the information to deduce key drivers and triggers of economic transformation.

The paper argues that economic transformation is an iterative, long-term process that requires constant support, attention and change. The process can be triggered by exogenous shocks but can also be a result of deliberate action – often the two working in conjunction (or sequence). Pragmatism is important to influence the pace and outcomes of transformative change. As part of the transformative process, the manufacturing sector is critical, but it is not the end game, and countries that have exhibited sustained transformation have also moved onto high-value services. Expertise in government is fundamental to promote change that is not diluted by ineffective politics, as is a good understanding that long-term economic transformation relies on building up local labour force skills, education levels and research and development (R&D) capabilities. The paper also argues that not all forms of economic transformation result in robust economic systems. For example, Bangladesh's reliance on garments makes it vulnerable to economic shocks. Finally, the paper finds that there are persistent knowledge gaps where more evidence is required.

The study faces two main limitations. The first is that missing data on certain variables mean that the paper cannot draw perfect comparisons. We chose to use the full data range available for each country; even though one-to-one comparisons were not possible, the aim was to preserve full data trends for each country, to avoid truncated paths were they to be shortened (or altogether removed) to match countries with limited or not available data.

The second main limitation has been the negative impact of the COVID-19 pandemic, which has significantly hindered progress on engaging stakeholders and fieldwork in the case study countries. This has meant that, with the exception of Sri Lanka, the majority of work is desk-based

and does not benefit from insights of stakeholders in the chosen comparator countries. Future work could help address this issue and allow fine-tuning of findings.

The paper is structured as follows. Section 2 discusses the theory behind these transformational pathways; based on the economic transformation literature, it aims to explain the driving forces of these transformational pathways. Section 3 shows what transformational pathways look like by comparing the developing country average,¹ five comparator countries and one in-depth case study country (Sri Lanka). Section 4 discusses the potential factors in the process of economic transformation across the comparator countries. Section 5 uses the information and data from the previous sections to build a picture of the factors behind economic transformation. Section 6 concludes by providing emerging lessons.

¹ Defined as low- and middle-income countries.

2. ECONOMIC TRANSFORMATION

The conceptual framework used to understand transitional pathways begins with the definition of economic transformation, as ‘the continuous process of (a) moving labour and other resources from lower- to higher-productivity sectors (structural change) and (b) raising within-sector productivity growth’ (McMillan et al., 2017). This section examines different ways that countries could potentially move along their economic transformation pathways using the theoretical literature as the basis. It is then used to as a reference framework.

The conceptual framework proposes three main pathways to economic: (i) moving resources² (i.e. labour, capital or policy focus) to more productive or competitive sectors; (ii) promoting the entry or growth of more productive firms; and (iii) improving productivity within firms. Even though most countries would state that the reallocation of resources should follow market principles, market failures may require some push in the right direction by the government (through fiscal policies or changes in the business environment) to channel resources towards desired outcomes.

The modalities of resource allocation differ and are often used in conjunction with one another – that is, the use of incentives (or disincentives) such as taxes or subsidies to allocate resources towards specific sectors, or the implementation of industrial development policy that favours certain sectors over others.

2.1. Promoting more productive sectors.

The existence of large gaps in labour productivity across sectors suggests that growth and development are in part the result of shifts in labour flows from low- to high-productivity sectors. This means that one of the key drivers of growth is the capacity to move resources from areas of an economy that are under-productive to areas (or, rather, sectors) of an economy that have higher productivity levels (McMillan and Rodrik, 2011). This typically means moving from traditional sectors such as agriculture to more modern sectors like manufacturing. Therefore, industrialisation is an important driver of growth. From the 1950s onwards, the countries that grew fastest were those that industrialised rapidly. The first wave was in Western Europe; these countries were followed by East Asian countries (Rodrik, 2013a).

Countries that shift their productive structure towards the manufacturing sector tend to increase their productivity levels. Using data from 118 countries (Rodrik, 2013a; Rodrik, 2013b) there is labour productivity convergence over time within the formal manufacturing sector. Countries whose initial productivity levels of manufacturing were low have shown faster productivity growth rates, converging gradually with the productivity rates in the manufacturing sectors of developed countries. These initial productivity gaps represent inefficiencies in the allocations of resources that hamper labour productivity, hence the reallocation of resources towards higher-productivity sectors, such as manufacturing, can result in higher growth rates. This has been the case in Asia, whereas in Africa and Latin America this process has not fully matured – hence the two regions exhibit lower average growth rates.

Diversification also contributes to growth, as higher rates of economic and export diversification are linked to higher levels of per capita income (Imbs and Wacziarg, 2003; Rodrik, 2013a) and productivity, as seen in Africa (Hammouda et al., 2010; McMillan et al., 2014).

² In terms of the ‘reallocation of resources’. A traditional theoretical description of the term posits that macroeconomic resource allocation can be undertaken through two distinct market systems. The first is the command system and the second is the market system. Direct allocation (or reallocation) of resources (between sectors or between firms) is strongly associated with centrally controlled markets where resource allocation is controlled by a central government. Market allocation of resources hinges on the theory that resources will be channelled towards their most efficient (or profitable) use by market players (i.e. firms).

2.2. Moving resources to higher productivity firms

It is possible to increase productivity by ‘reallocating’ resources to more productive firms. Productivity differences can be noted between firms within the same sector. These differences can occur for a range of reasons, such as different uses of labour (labour and employment practices as well as different labour skill mixes), different capital intensities of production or even different positions within a value chain (either domestic or international). Examples of such differences are seen in Cambodian manufacturing (USAID, 2005), China and India (Hsieh and Klenow, 2009) and in developed economies such as the US (Foster et al. 2005).

Certain factors can influence productivity levels between firms. Higher firm entry and exit rates could increase productivity levels, as new firm entrants usually either have higher productivity levels, such as in Sweden (Andersson, 2007), or rapidly catch up with incumbent firms, as seen in Taiwan (Aw et al., 2001), whereas exiting firms tend to have lower productivity levels. Innovation and technology level within firms will also increase productivity.

2.2. Increasing firm productivity

Productivity improvements within firms also contribute to the economic transformation process. Technology levels will have an impact on productivity (Doms et al., 1997; Basu et al., 2006), as more technologically advanced firms will have greater levels of productivity. R&D and labour skills are also strongly, positively, correlated with increased productivity, and especially important in the productivity catch-up process (Griffith et al., 2000). Similar results show that there is total factor productivity growth in industries where there is development in the technological frontier (Dabla-Norris et al., 2015).

Firm participation in international trade increases productivity, as when a sector is exposed to international trade, the more productive firms within the sector will enter the export market. As an industry is further exposed to international trade, resource allocation from less to more productive firms strengthens (Melitz, 2003). Integration into global value chains can also increase productivity (Kowalski and Buge, 2013) while increased competition from foreign firms may have the same effect on competing domestic firms (Tybout, 2001). Firms that decide to enter the export market also see higher productivity levels, for example for manufacturing firms in India (Mukim, 2011), particularly thanks to the learning-by-exporting process (Thomas and Narayanan, 2012). Some evidence from Ethiopia suggests it may be also be the case that firms entering the export market already have a higher productivity rate than their non-exporting peers (Siba and Grebeeyesus, 2014).

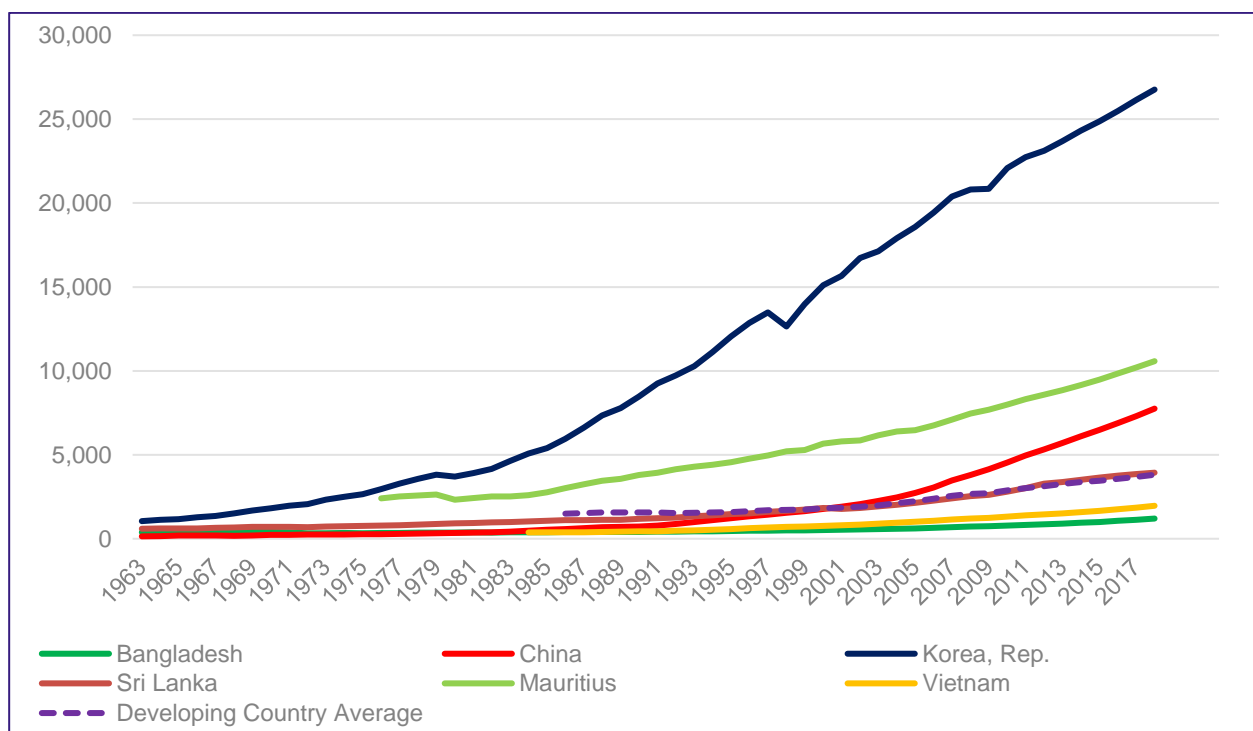
3. EMPIRICAL PATTERNS OF ECONOMIC TRANSFORMATION

The following section compares economic transformation outcomes out of six developing countries that have exhibited transformational outcomes over the past five decades. The aim is to identify and possibly classify transformational pathways and identify inflection points – that is, the ‘moment’ when the change occurred (in measurable terms). The comparison broadly follows the approach laid out by Mendez-Parra et al. (2018), who identify methods to identify economic transformation patterns at the country level using several diagnostic tools (see Annex for a more detailed table summarising the approach).

The section compares six countries (Bangladesh, China, Mauritius, South Korea, Sri Lanka and Vietnam) with the developing country average for a set of indicators representative of economic transformation. These six countries have been chosen as demonstrators as each one has exhibited some degree of economic transformation over the past few decades, hence can provide some insight into what transformational patterns could look like.

The comparison identifies patterns in economic transformation pathways and highlights divergences from the developing country average pathway. For the purposes of this comparison, developing countries include those the World Bank classifies as upper-middle-, lower-middle- and low-income countries.

Figure 1: GDP per capita, 1963–2018 (US\$ 2010 constant)

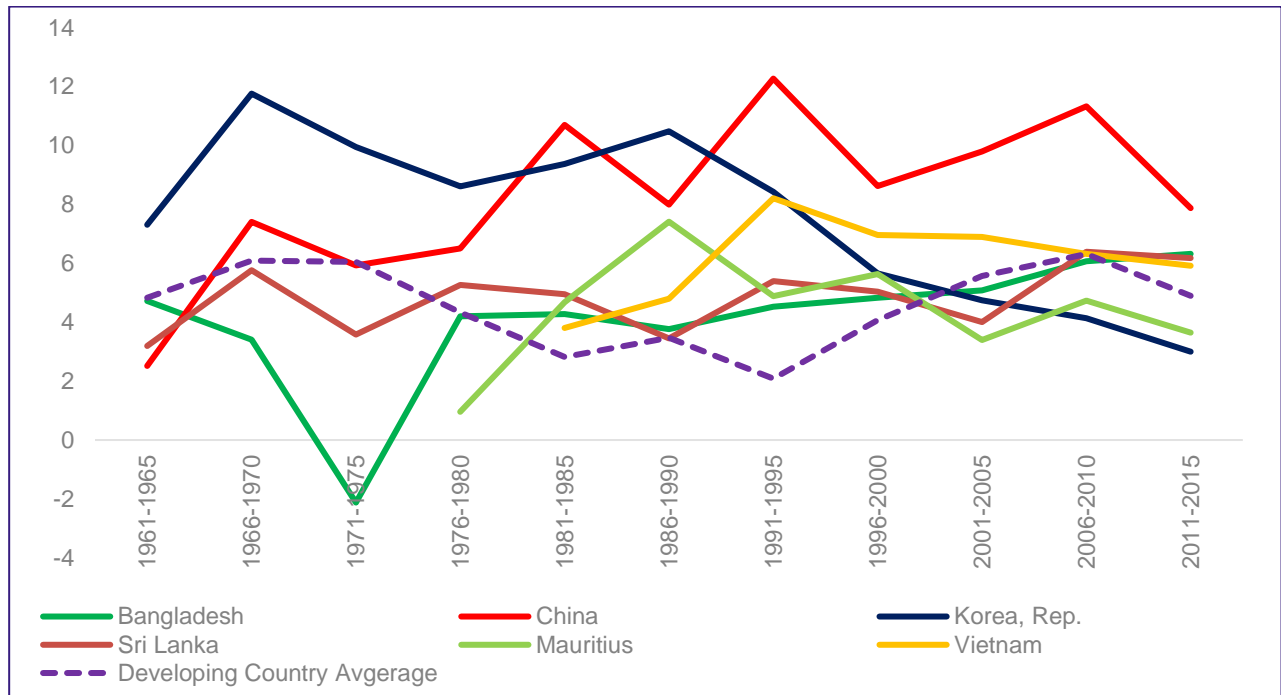


Source: WDI 2020

The first comparison shows changes in gross domestic product (GDP) per capita (in nominal 2010 US\$ terms). Figure 1 shows which countries have exhibited the fastest economic growth rates once population growth has been controlled for. The most striking pathway is that of South Korea, which, around 1963, showed a GDP per capita at broadly the same level as that of China and Sri Lanka; by 2018, its GDP per capita was at approximately \$27,700, whereas China’s was at \$7,700 and Sri Lanka’s at approximately \$3,800 (broadly the same level as the developing country average for 2018).

Although China did not exhibit as rapid a growth as South Korea, together with Mauritius it provides two additional examples of notable growth in GDP per capita. South Korea illustrates a longer and deeper growth trajectory, starting in the mid-1960s. Mauritius exhibits growth from the late 1970s, whereas China begins its growth trajectory only in the early 1980s. These are important points to note as Section 4 later illustrates how each of these identified time points correspond to significant economic reforms processes carried out in each country.

Figure 2: GDP growth, five-year average, 1961–2015 (%)

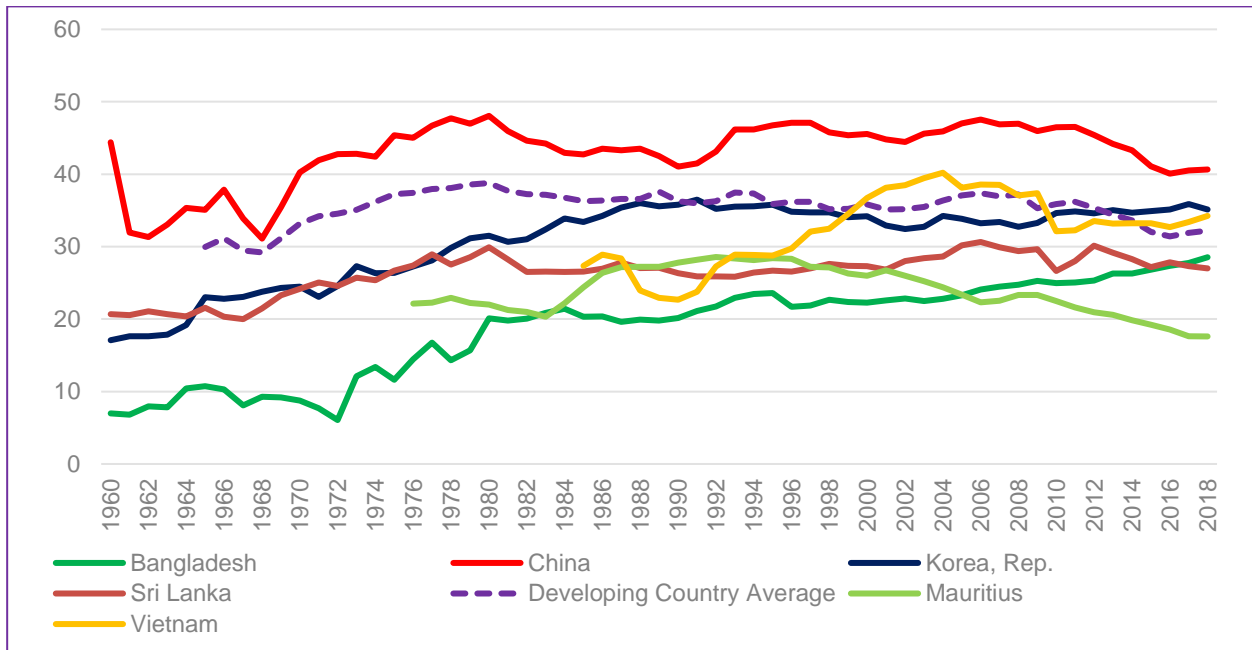


Source: WDI 2020

Looking at the average five-year GDP growth rates, in percentage terms, between 1961 and 2015 (figure 2), a sustained period of relatively high growth in South Korea is evident between 1966 and 1990; Chinese growth begins in 1981, maintaining relatively high levels of growth up to the early 2010s; and Mauritius exhibits a period of growth 'catch-up' from the early 1980s up to the late 1990s. Bangladesh begins its post-conflict recovery process in the late 1970s; however, it is only from the mid-1990s onwards that its growth rates increased substantially. Vietnamese data do not stretch as far back the 1960s; however, the impacts of the Doi Moi reforms are evident as growth picks up only after the mid-1980s when these reforms were implemented. Sri Lanka exhibits a relatively constant rate of GDP growth, between 3% and 6% annually. Across all six countries, it was the period from the early 1980s up to the early 2000s that saw increased growth relative to the developed country average; hence, the reforms that occurred in the period could be particularly significant in terms of promoting growth.

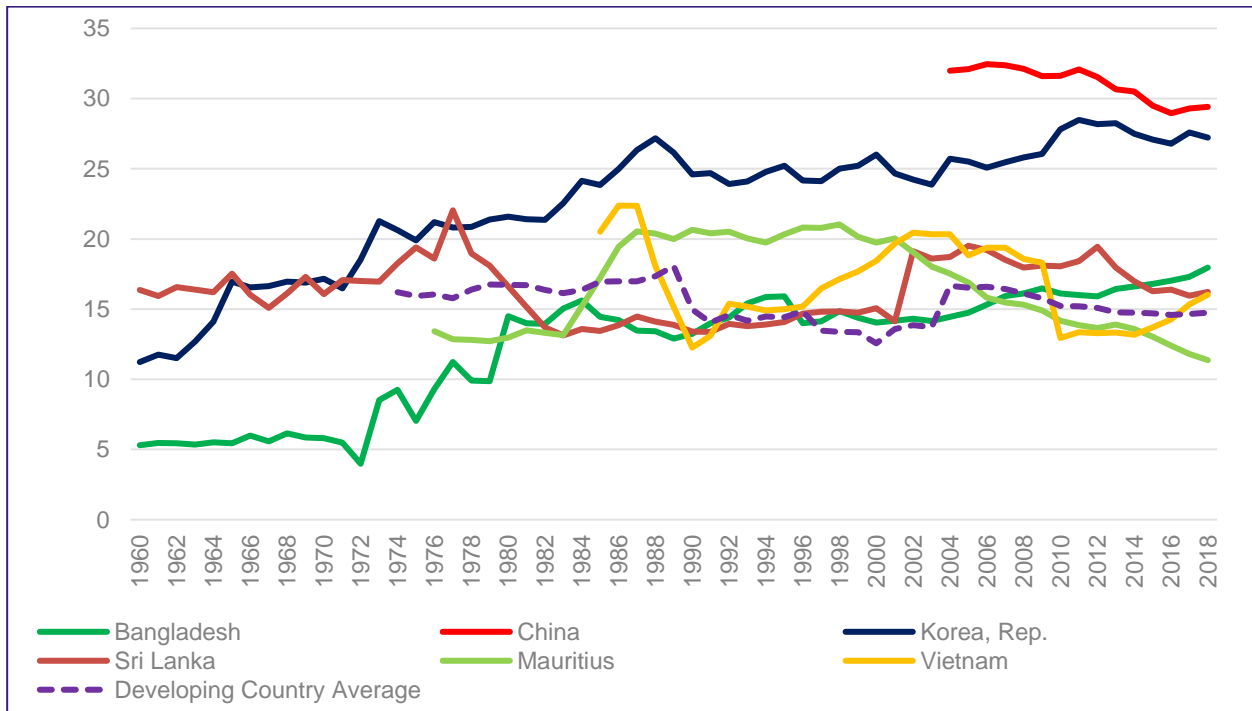
The next structural change comparison (figure 3) examines industry (as a percentage of GDP) between the six comparator countries and the developing country average. Although data are not consistent across all countries, we see that China's industrial sector has been consistently larger than the developing country average whereas Vietnam overtook the average from the early 1990s onwards. Both Sri Lanka and Bangladesh exhibit significant growth in their industrial sectors. Sri Lanka's industrial sector exhibits convergence with the developing country average since the mid 1970s (with some fluctuations over the decades), whereas Bangladesh shows rapid growth from the early 1970s, culminating in convergence with the average around the early 2010s. Mauritius shows initial convergence in the 1990s but a decline from the mid-1990s onwards.

Figure 3: Industry (including construction), 1960–2018 (% of GDP)



Source: WDI 2020

Figure 4: Manufacturing, 1960–2018 (% of GDP)



Source: WDI 2020

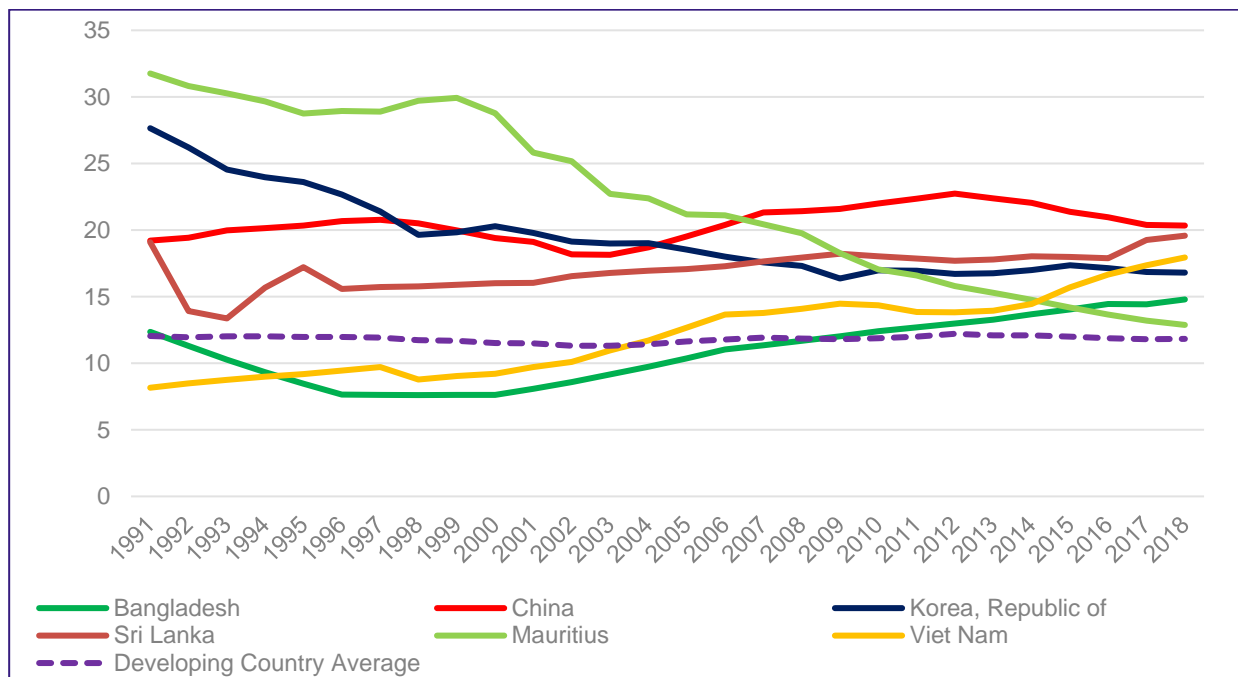
Figure 4 looks at the manufacturing sector in more detail (as one of the components included in industry, which also includes construction, for example). Data limitations, especially for China, hinder a full historical and comparative view; however, comparisons of developing country manufacturing (as a percentage of GDP) identify three interesting periods. The first is for Mauritius from the mid-1980s until the late 1990s, when its manufacturing sector was significantly above the developing country average until it began its current period of decline. The second is the rapid growth of Bangladesh manufacturing sector from the early 1970s onwards, allowing it to overtake the developing country average from approximately 2008. The third is Vietnam’s initial decline in

the late 1980s followed by a recovery in the early 1990s. Of note, WDI data on Chinese manufacturing are available only from 2005 onwards, which limits country comparability; similarly, data from Vietnam and Sri Lanka are also time limited, although to a lesser extent.

Industrial employment in Mauritius maintains a relatively high level (approximately 40% of total employment) between the early 1990s and the early 2000s, with this followed by a period of decline until 2019, albeit still maintaining levels similar to those of China, Vietnam and Sri Lanka. The remaining comparator countries all show increases in their relative levels of industrial employment, converging and then overtaking the developing country average, except for Bangladesh, where the level is approximately that of the developing country average. The highest relative growth is seen in Vietnam from the late 1990s, with Bangladesh following a broadly similar trend. Both China and Sri Lanka exhibit relative growth from the early 2000s.

The most evident trend is the sharp decline of manufacturing employment in Mauritius, particularly from the late 1990s onwards, when it had the highest level of manufacturing employment (around 30%), falling to around 15% by 2019. China and Sri Lanka show similar trends; whereas Sri Lanka shows continuous growth from the mid-1990s, China shows an initial decline from the mid-1990s to the early 2000s followed by a period of growth until the mid-2010s, followed by a second (current) period of decline. Bangladesh and Vietnam also show similar growth patterns, Bangladesh exhibiting constant growth from the late 1990s and Vietnam showing the same trend from the early 2000s.

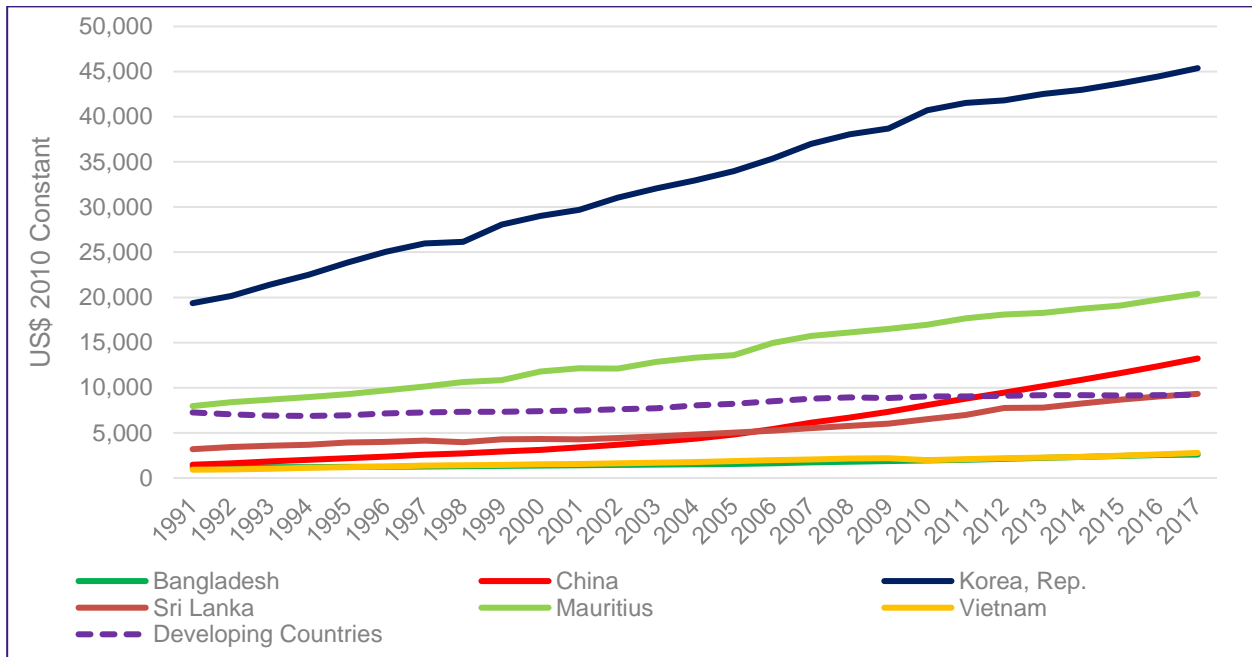
Figure 5: Manufacturing employment, 1991–2018 (% of total employment)



Source: ILO WESO 2020

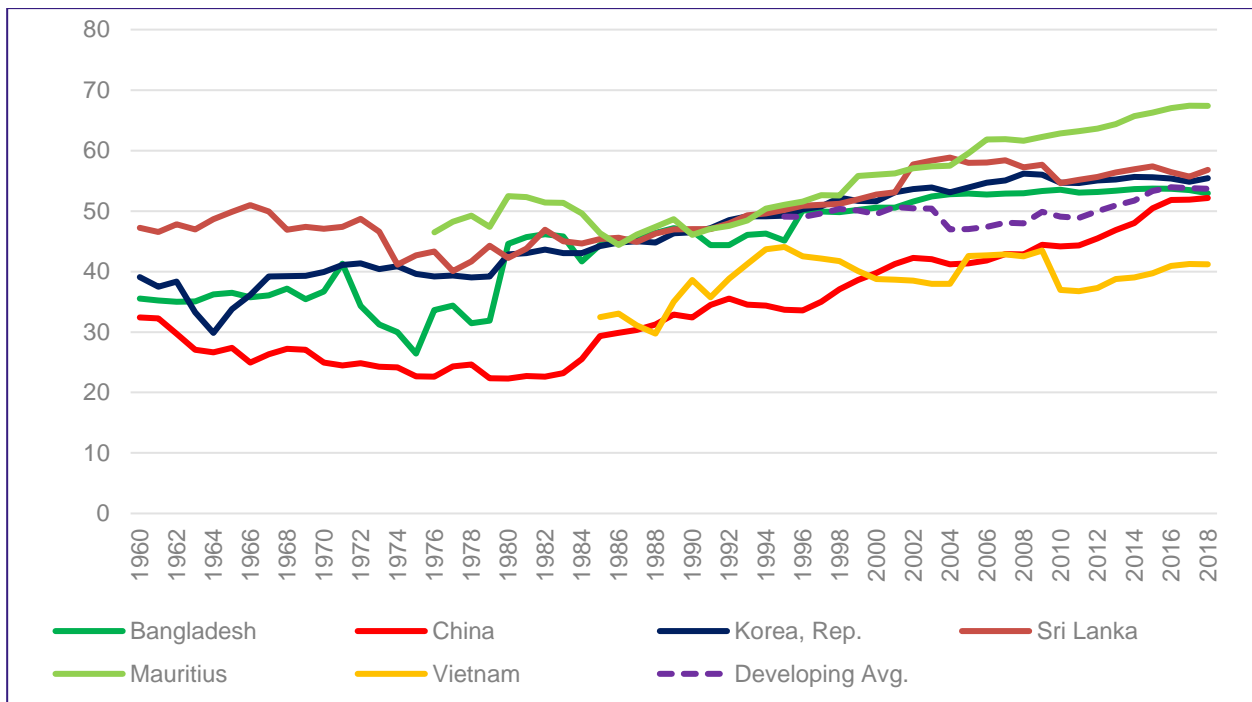
A comparison of labour productivity highlights three interesting trajectories. The first is sustained growth in labour productivity in Mauritius. In 1991, Mauritian labour productivity was just above the developing country average; by 2017, the level had almost tripled (181% growth), whereas the developing country average grew by only 27% in the same period. The second trajectory is a Chinese shift in growth from approximately 2004 onwards. While Chinese labour productivity was exhibiting growth before this period, there was an upward inflection in 2004, which allowed China to overtake the developing country average by 2011. The final trajectory is for Sri Lanka, which shows an increase in the labour productivity growth rate from 2006 onwards, to reach the developing country average by 2016.

Figure 6: Labour productivity, annual GVA per worker, 1991–2017 (US\$ 2010 constant)



Source: ODI SET Data Portal

Figure 7: Services, 1960–2018 (% of GDP)

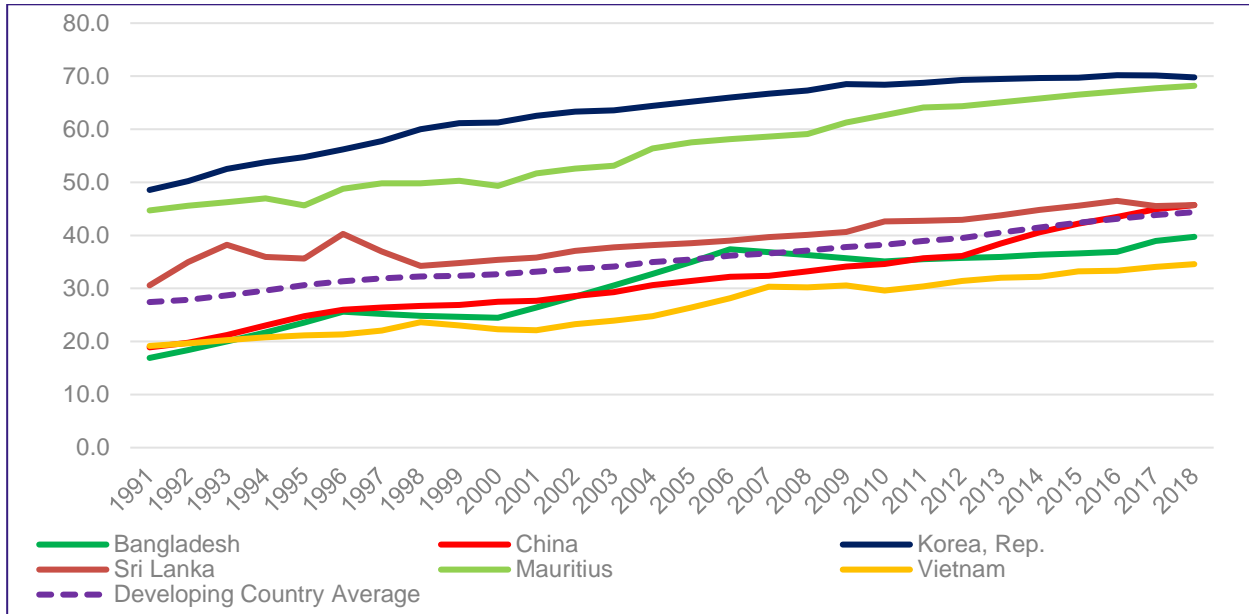


Source: WDI 2020

All comparator countries as well as the developing country average show consistent growth in their service sectors (as a percentage of GDP, figure 7 above). China exhibits the largest relative growth: out of the comparator countries it had the lowest service sector percentage; however, it has maintained growth in services since the early 1980s, eventually matching the developing country average by 2017. Relatively higher growth is exhibited by Mauritius and Sri Lanka, particularly from the mid 1980s onwards, although Mauritius has maintained its growth rate whereas Sri Lanka seems to have plateaued from the early 2000s onwards. Vietnam saw a period of relatively higher growth from the late 1980s but this growth was not sustained from the early

1990s onwards. Bangladesh sees an initial decline from the early 1970s to the early 1980s, followed by a growth period to match the developing country average by 2018. Services sector growth is seen across all countries as well as for the developing country average. China exhibits sustained growth from the early 1980s, a trend also seen in Bangladesh and Sri Lanka. South Korea started earlier, with growth in the sector commencing in the mid-1960s. On the other hand, the Mauritian service sector began its growth trajectory in the late 1980s while Vietnam shows erratic growth from the mid-1990s onwards.

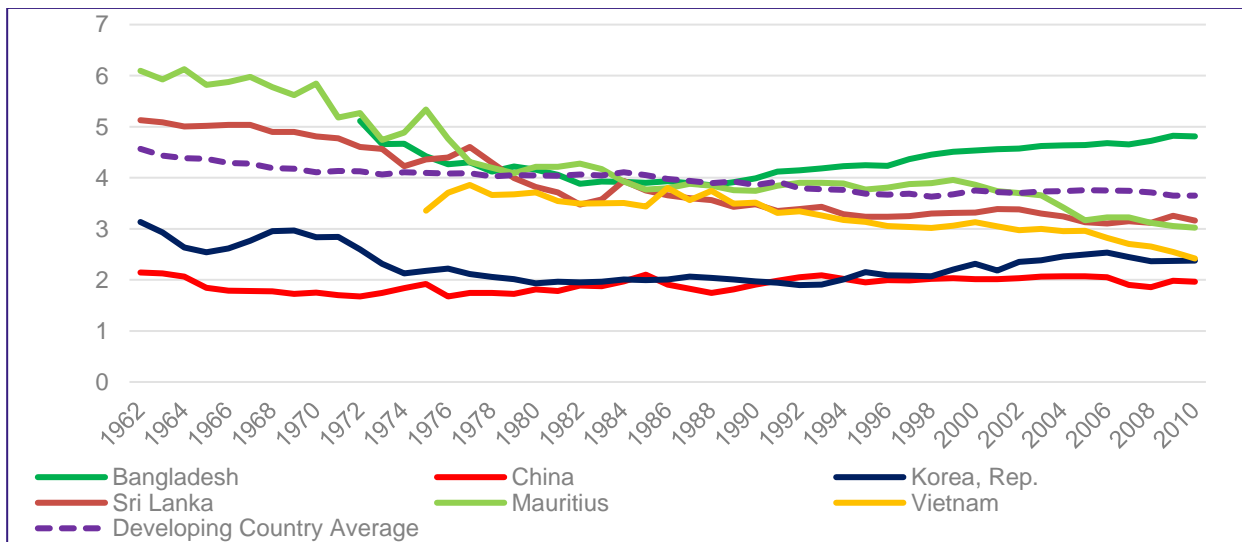
Figure 8: Services employment, 1991–2018 (% of total employment)



Source: ILO WESO 2020

Services sector employment (figure 8) shows the same broad trend across all comparator countries as well as the developing country average. Mauritius shows consistently high levels of service employment, growing from 20% in the early 1990s to more than 40% at present. China shows steady growth throughout the period. Bangladesh shows a period of rapid growth until 2006, followed by small decline until 2016 and subsequent growth. Sri Lanka exhibits consistent growth from the late 1990s onwards whereas Vietnam plateaus in the late 1990s to the mid-2000s but subsequently resumes growth in services employment.

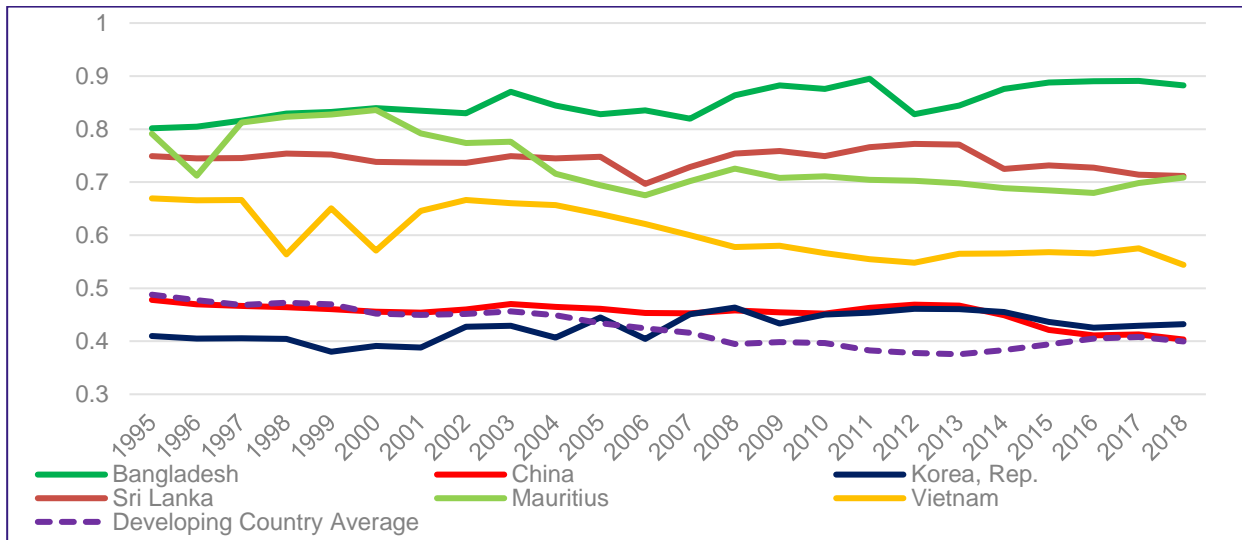
Figure 9: IMF Export Diversification Index (lower = more diversified), 1962–2010



Source: IMF Export Diversification Index 2020

Comparing export diversification scores, where lower scores indicate increased export diversification levels (figure 9 - data available only until 2010), all countries (including the developing country average) except Bangladesh and South Korea show increased diversification. Mauritius and Sri Lanka both show the greatest degree of diversification; for Mauritius, diversification was consistent from the late 1970s onwards, for Sri Lanka it was from the mid-1980s onwards. Vietnam also exhibits increased export diversification levels from the late 1980s onwards.

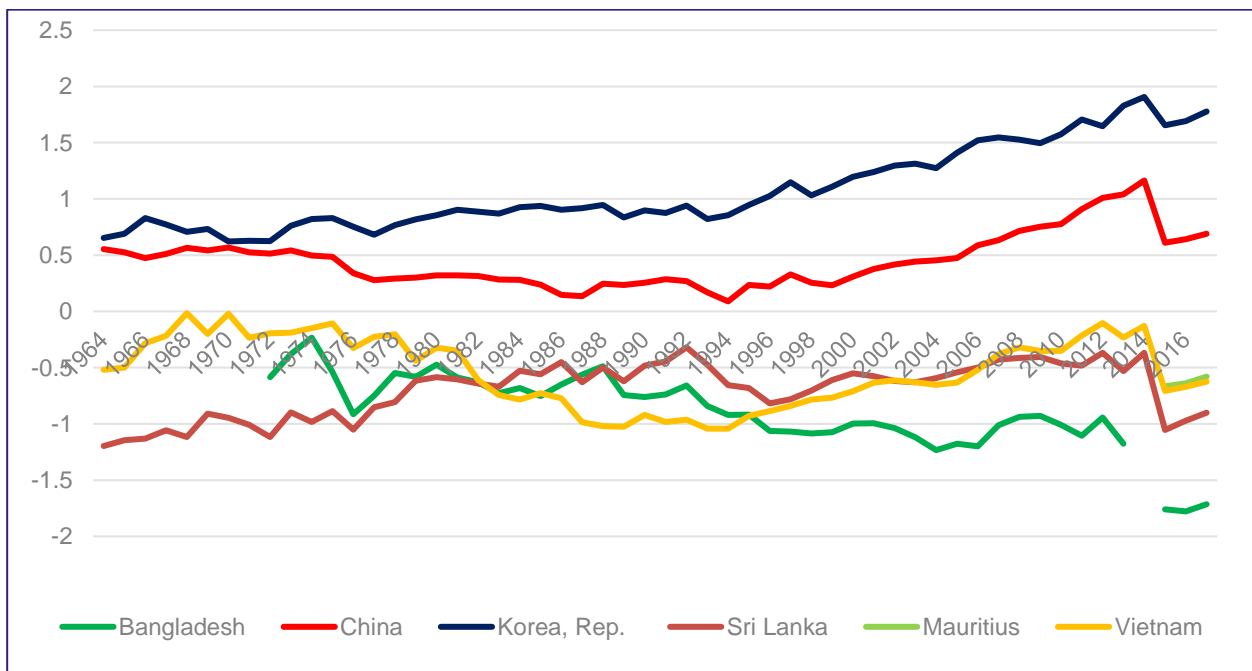
Figure 10: UNCTADstat Export Diversification Index, 1995–2018



Source: UNCTADstat 2020

Economic complexity (figure 11) shows two distinct periods for nearly all comparator countries. The first is the pre-1990s period, when nearly all countries, except Sri Lanka, show a decrease. The second period is from the 1990s to the mid-2010s, when all countries, except Bangladesh, saw an increase on their Economic Complexity Index (ECI).

Figure 11: Economic Complexity Index rankings, 1964–2017



Source: Observatory of Economic Complexity country data 2020

Economic complexity in Bangladesh trends downwards throughout the whole period³. China shows a relatively shallow decline before the mid-1990s then a constant increase, barring a decrease in 2014-2015 which was followed by an increase in the 2015-2016 period. Sri Lanka shows an initial period of increased complexity until 1992, followed by a short period of decline until approximately 1998, followed by a second increase period. Finally, Vietnam exhibits the most dramatic shift, with a two-decade period of initial significant decline lasting from 1976 to 1996, followed by a dramatic recovery period.

There is a shared period of steep decline in ECI scores across all comparator countries between 2014 and 2015; this change is unclear and should be investigated further. Mauritius data begin only in 2015, hence its comparison is not possible; however, its economic complexity score is higher than all other comparator countries barring China.

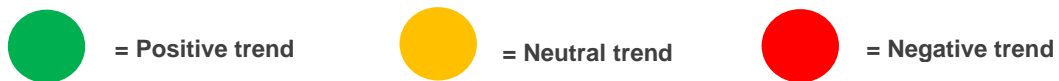
Table 1 summarises the main findings of the comparison exercise. It classifies identified changes according to positive economic transformation shifts (in green), neutral transformation (in orange) and non-transformative (i.e. negative) shifts (in red).

³ The chart does not provide an average as the structure of the ECI ranking means that an average score would not provide relevant information.

Table 1: Summary table of economic transformation trends for comparator countries during the 1970-2018 period

Measure		China	Bangladesh	Vietnam	Mauritius	Sri Lanka	South Korea
<i>Does the country exhibit structural transformation in terms of GDP?</i>	Industry	●	●	●	●	●	●
	Manufacturing	●	●	●	●	●	●
	Services	●	●	●	●	●	●
<i>Are there changes in the sectoral employment composition?</i>	Industry	●	●	●	●	●	●
	Manufacturing	●	●	●	●	●	●
	Services	●	●	●	●	●	●
<i>Has Labour Productivity Increased?</i>		●	●	●	●	●	●
<i>Has Export Diversification Increased?</i>		●	●	●	●	●	●
<i>Has Economic Complexity Improved?</i>		●	●	●	●	●	●
<i>Does the Product Space exhibit a greater prevalence of higher complexity goods?</i>		●	●	●	●	●	●

Source: Analysis in this paper – see the annex for a more in-depth descriptive summary table explaining the scores presented here



The comparison above allows us to identify some trends in the transformative pathway of the six comparator countries. It has identified several notable transformation examples, including:

- the emergence of Bangladesh's garment sector in the early 1980s followed by lack of diversification largely until now
- the emergence of Sri Lanka's garment sector and increased productivity and quality in this sector and gradual movement into services
- the rapid increase in export-oriented manufacturing in China based on special economic zones (SEZs) from 1979 onwards
- Vietnam's move into manufacturing and subsequently into services
- the remarkable changes in sectoral structure in Mauritius from agriculture into textiles and garments, which was followed by a shift towards high-value services with a subsequent decline in relative importance of industry and manufacturing
- South Korea's sustained manufacturing growth and shift in manufacturing output from low-value garments into higher-value electronics, vehicles and chemicals, moving into higher value services which have overtaken industry as a whole even though the manufacturing sector remains relatively important in terms of GDP.

Following this process, the next step is to understand potential factors behind these trends (i.e. shifts in policy, technology, trade, etc.), and especially combinations in these, and the drivers behind these changes.

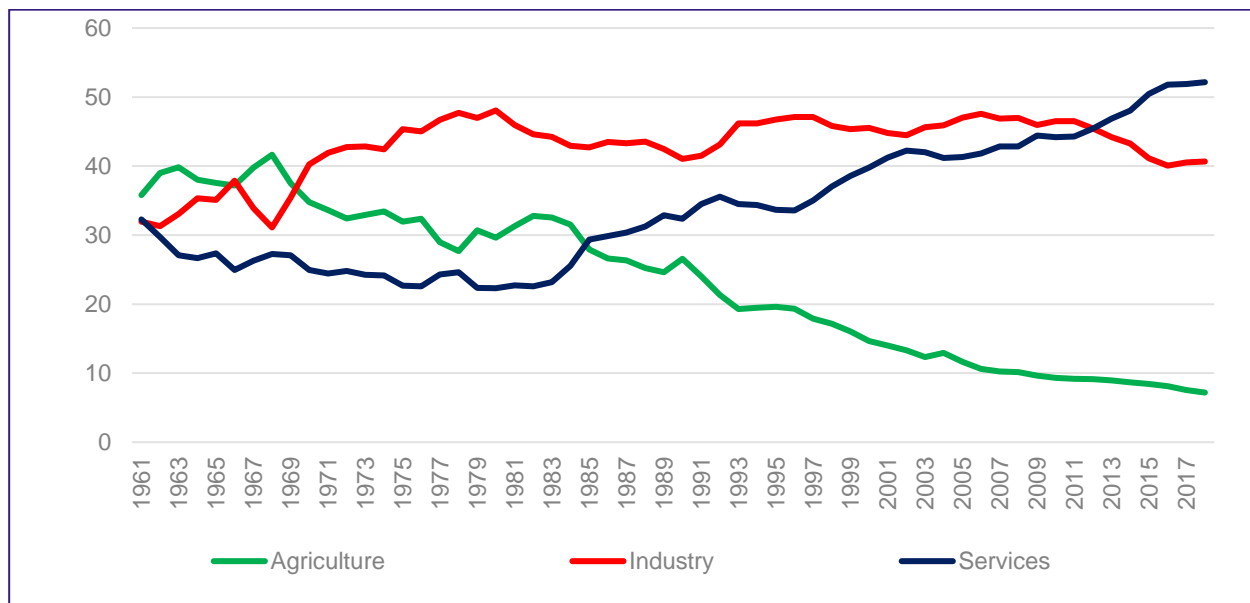
4. ECONOMIC TRANSFORMATION IN SIX CASE STUDIES

This section reviews economic transformation pathways in six case study countries: China, South Korea, Vietnam, Bangladesh, Mauritius and Sri Lanka. The aim is to provide a more in-depth discussion of the causes, both internal (e.g. government policies) and external (such as international trade agreements), that have influenced the countries' transformational trajectory. The section also examines employment gains in transformative sectors (manufacturing and services) in each country in terms of gender and the urban/rural divide, with the aim of understanding if the transformative process has improved the transformative opportunities for females and for rural area inhabitants. Finally, each country case study concludes with a top-level summary of the identified triggers, enablers, labour factors and policy processes that contributed to its economic transformation process.

4.1. China

China embarked on its transformational pathway and its transition towards a market economy in 1978. Deng Xiaoping embarked on the modernisation process that moved the country on the path to industrialisation and opened it up to international trade. The country shifted from an agrarian society towards industry and subsequently services in the span of approximately 30 years (see figure 12), becoming one of the largest economies in the world.

Figure 12: Chinese structural transformation, 1961–2018 (sectors as a % of GDP)



Source: WDI 2020

At the end of 1978, Deng Xiaoping announced that the Chinese Communist Party had decided to 'reform and open' the Chinese economy. This process was coupled with an informal decision to move away from the previous system of absolute government authority held by one figure (Mao Zedong) into a system where the party chairman shared some of their authority with a small collective leadership system composed of the party patriarchs (Ang, 2017). The main aim of such a move was to curtail potential power abuse and limit damages of potentially unwise economic decisions that could otherwise occur under a single authority figure. Before the transition, in the 1970s, China's GDP per capita was lower than the sub-Saharan African average.

Lin (2018) attributes China's rapid economic growth to one major factor: the relative technological 'backwardness' of the country *vis-à-vis* Western economies. The catch-up process that China

engaged in from the late 1970s onwards was able to avoid a number of potential risk and cost factors: the country essentially leapfrogged ahead to use technologies that were both developed and regulated for (with associated trial and error in regulations and laws) by other countries, which took the associated risks and costs. By reducing the costs of innovation, upgrading and economic transformation, China took advantage of this catch-up process to adopt a highly successful international trade strategy. This was based on importing the goods that other countries already knew how to produce better and exporting the goods that other countries needed. That is, it took advantage of its relative comparative advantages to help its export base move away from primary and processed goods in the late 1970s on to an export base of continually upgraded manufactured goods.

An important aspect in the success of China's strategy was its dual-track approach to its market transition. A common aspect of developing country structural transformations has been the evolution of governing principles, from protectionist measures in the 1970s and 1980s on to liberalisation processes in the 1990s and 2000s. Lin (2018) posits that, whereas other developing countries failed to properly pace this process, China maintained a pragmatic approach. The country initially kept 'distortions' that protected private sector firms in vulnerable industries that would otherwise have collapsed in the face of full liberalisation and competition from the international market. This is essentially what happened in other developing countries that were following the liberalisation approach. The aim of China's gradual approach was to give the country enough time to modernise its infrastructure, business environment and technical capacities. In lieu of full liberalisation, China decided to promote industrial upgrading by targeting foreign investment through SEZs, and to promote rural development and industrialisation through township and village enterprises (TVEs).

As part of this dual-track approach, the Chinese government also carried out a process of gradually allowing private enterprises to meet internal market demand, which central authorities had often neglected in favour of investments in centrally planned industrial projects (Naughton, 2015). Rural communities could set up TVEs, which would contribute to local investment and economic growth. TVEs eventually led to industrial activities overtaking agrarian activities in terms of rural income generation by 1987 (Ang, 2017). TVEs were incentivised by allowing local authorities to keep a larger proportion of tax revenues and all profits generated, rather than moving these to the central authority, as had previously been the case for rural enterprises. This incentivised local authorities to set up TVEs; at the same time TVEs helped fill in market gaps in rural areas.

The rural economy was also boosted by reforms to the agricultural system. Previously, farmers had operated under a collective production system and had been obliged to meet government-mandated procurement targets at low prices. This had disincentivised investments in agricultural productivity. Reforms first allowed farmer households to manage their own plots of land and lowered procurement targets; however, beyond the procurement target, farmers were allowed to sell produce on the open market. This led to a surge in agricultural productivity (aided by increased availability of modern farming inputs), which in turn helped free labour from agriculture and secure food stocks in the country (Naughton, 2015).

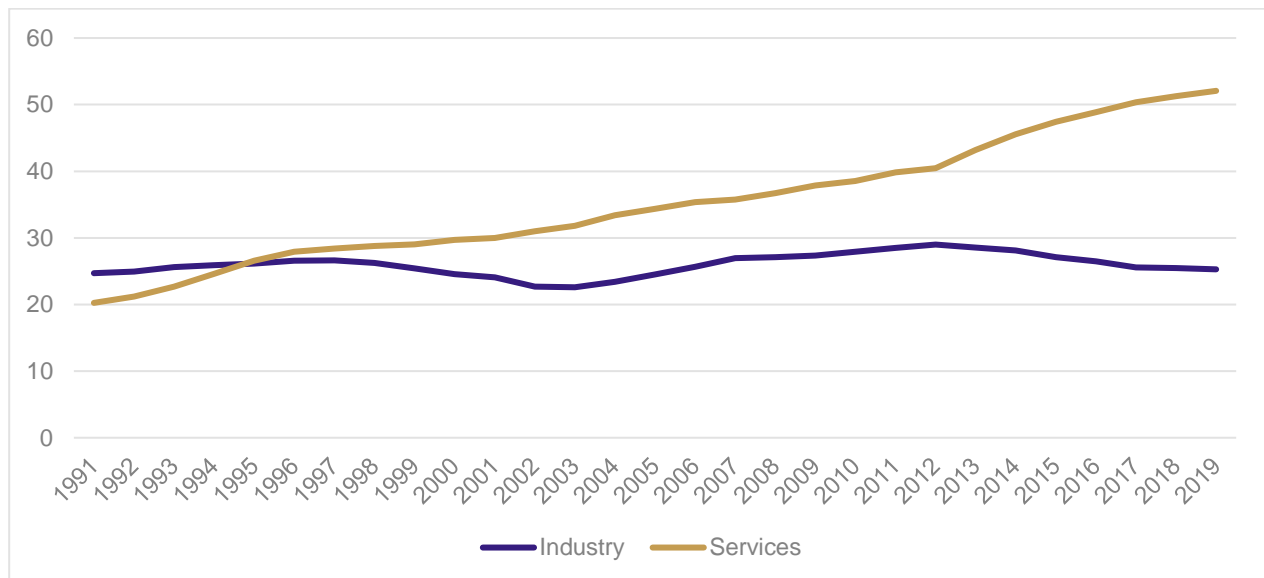
SEZs were chosen as a potential solution as the Communist Party felt that such a system had yielded positive economic results where it had been implemented (Ang, 2017). The SEZs benefited from focused investments in infrastructure, which, coupled with cheap surplus agrarian labour, made them attractive production areas for investors (Lin, 2018). The Chinese government proactively sought foreign investments from countries on the cusp of product upgrading in relocating their labour-intensive processes in China. The Chinese government also provided fiscal incentives for foreign manufacturing firms to relocate factories in its SEZs. From a political perspective, this move was accompanied by a process of decentralisation to give more power to provincial authorities, in order to ensure that they would also benefit from the economic reform process, and also deciding not to 'dismantle the pre-existing web of Leninist institutions but instead weave strands of capitalism at the fringes' (Ang, 2017).

Using this approach, the Chinese government avoided the collapse of existing industries and at the same time began the process of industrial upgrading by spurring investment in the country, which would eventually lead to technical knowledge transfer, in turn helping upgrade labour capabilities. This process of gradual liberalisation was a ‘reform achieving efficiency without creating losers’, which required continuous enforcement of rights and obligations of involved stakeholders. This was deemed not to be a particular problem in China, given the strength of the government (Lau et al., 2000). An important condition to this success was a shift in both the output decision-making process and the profit distribution system that the Chinese government had enacted (Groves et al., 1994). The government decided to relinquish control of firm-level output decision-making processes to firms themselves (rather than maintaining central control), as well as allow private firms to retain a greater share of their operational profits. This approach was meant to tackle issues with labour productivity, as the theory was that a greater proportion of profits retained by private firms would allow firm managers to increase remuneration for their workers, in turn spurring greater worker participation and productivity (ibid.).

4.1.1 Labour Force Outcomes

Employment outcomes of the transformative process, by gender (figure 13), show an increase in the percentage of employed females working in services between 1991 and 2019 but no significant change for manufacturing. The female wage gap⁴ seems to have increased from females earning approximately 103% of male wages in 2002 down to 83% in 2013;⁵ whilst the female labour force participation rate also decreased from 70% to 61% over the same period. Informal employment was estimated at approximately 23% in 2013, down from 52% of total employment in 2007.

Figure 13: Female employment in services and industry, China, 1991–2019 (% of total female employment)



Source: WDI 2020⁶

There is a notable change in the divide between rural and urban employment in China (figure 14). Until the early 1960s, there appears to have been some (relative) stability in the trend, with rural

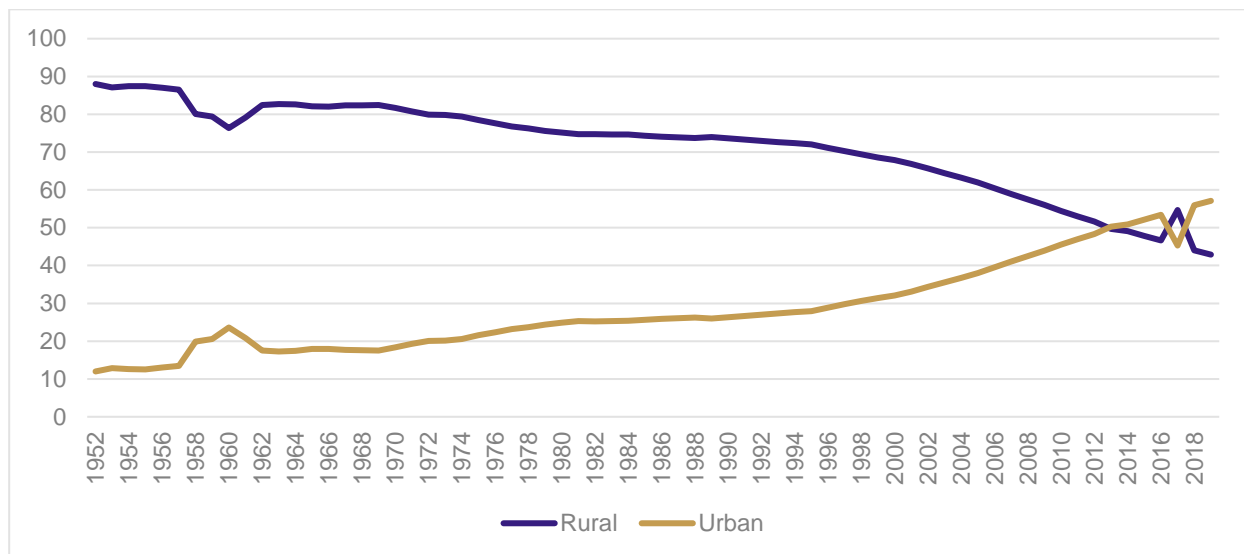
⁴ Defined as the ratio of female median wages on male median wages.

⁵ World Bank Global Jobs Indicator Database (JOIN), accessed October 2019: <https://datacatalog.worldbank.org/dataset/global-jobs-indicators-database>

⁶ The other six countries use a more detailed employment in manufacturing and services by gender dataset; these data (ILOSTAT 2020) were not available for China, hence the proxy World Bank (WDI 2020) data were used instead.

areas accounting for 90% of employment. By the mid-1960s, the gradual reversal of this trend had begun; however, the reversal did not effectively occur until the early 2010s, a significant period after the reform process began in the mid-1980s.

Figure 14: Rural/urban employment in China, 1952–2018 (% of total employment)



Source: ILOSTAT 2020

4.1.2 Identified Triggers, Enablers, Labour Force and Policy

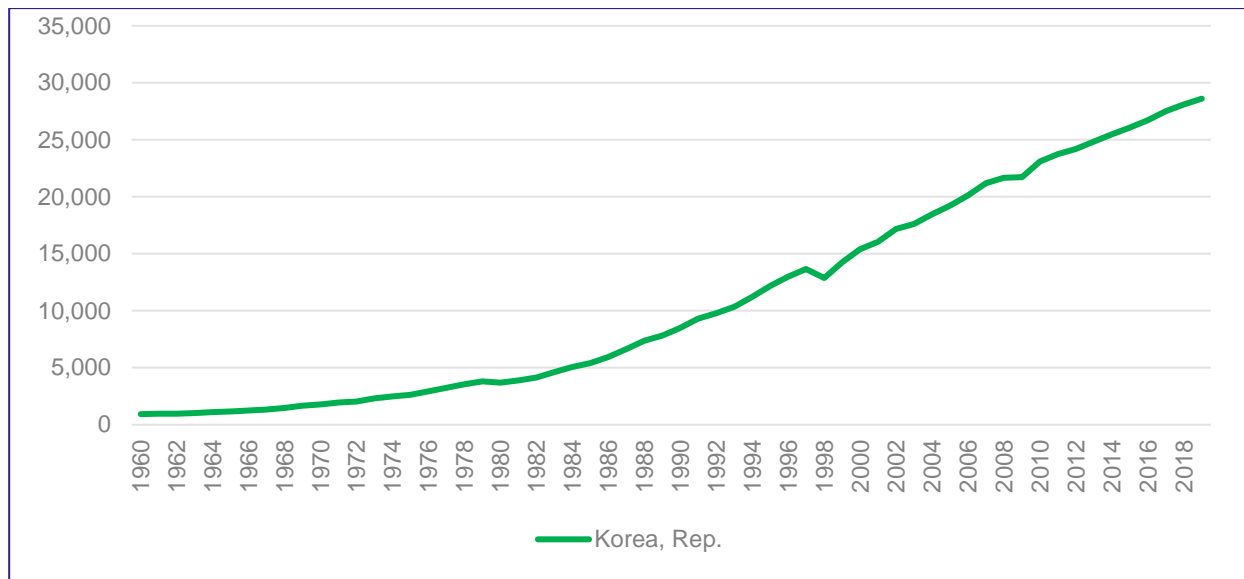
Based on the above analysis we can identify the triggers, enablers, labour factors and policy processes that contributed to China's economic transformation process

- **Triggers:** Change in top level leadership due to the death of Mao Zedong combined with previously limited progress on economic development, leading to a planned change in governance style and approach to economic development.
- **Enablers:** Strong government which provided the capacity to carry out pragmatic economic reforms combined with the use of experts and evolving institutional structures to guide economic policy and decision-making processes.
- **Labour Force:** An abundant and relatively cheap labour supply beneficial to low cost manufacturing.
- **Policy:** The dual track approach combined privatisation with liberalisation and focussed on export-based manufacturing through the implementation of SEZs. Policy support to R&D allowed the advancement of manufacturing and services into higher-value sectors.

4.2. South Korea

South Korea's economic development began in the early 1960s, when it moved from a predominantly agrarian society to an industrial economy over the span of approximately 30 years. The country progressed from a GDP per capita of \$932 (constant 2010 US\$) in 1960 to \$28,091 (constant 2010 US\$) in 2018 (see figure 15). It is one of the very few countries that have progressed from low-income to high-income status in one generation.

Figure 15: South Korean GDP per capita, 1960–2018 (constant 2010 US\$)



Source: WDI 2020

In 1961, South Korea's government was taken over in a military coup led by Park Chung Hee. The government prioritised economic development through a combination of state-led planning and private sector activities (Sakong and Yoh, 2010; Seth, 2017).

From a political perspective, Park's government saw economic development as the means to legitimise the military's takeover of South Korea. As such, in 1962 it launched South Korea's first five-year development plan (Park, 2019). The reform process essentially coupled export promotion with government-led industrialisation. The export promotion push was initially spurred on by a gradual depletion of South Korea's foreign currency reserves and was enacted through the 'export–import link system', which allowed exporters to import goods equal to the value of their exports. This was coupled with a previous phase of two rounds of planned currency devaluation to promote exports in 1960, which led to a rapid increase in export growth between 1960 and 1964.

The South Korean government subsequently decided to step up promotion of exports through a number of additional initiatives. It changed its currency exchange system from a fixed rate to a variable rate in 1964, which immediately halved the value of the won (compared with the US dollar). It subsequently phased out export subsidies and the import–export link system while bolstering export credit availability (and lowering interest rates) and reducing tariffs on imports (Sakong and Yoh, 2010). In the late 1960s and early 1970s, export firms were also provided tax incentives while firms setting up in identified key industries were provided three-year tax exemptions.

The government also set up a systematic system of state–business collaboration to bolster exports. Export targets were formulated collaboratively between the private sector and the government for key industries⁷ and monthly meetings were held between government and business representatives to analyse export trends and help resolve problems if export targets were in jeopardy (Lall, 2000; Sakong and Yoh, 2010). These meetings were given significant authority to enact solutions, as they were chaired by the South Korean president (Sakong and Yoh, 2010). The government also set up the Korea Trade–Investment Promotion Agency in 1962 (KOTRA, 2020),⁸ which helped build international trade networks and market the activities of Korean firms abroad as well as build market information for Korean exporters.

⁷ Particularly sectors defined as heavy and chemical industry (HCI).

⁸ <https://www.kotra.or.kr/foreign/kotra/KHENKT160M.html>

The second aspect of the reform process was government-led industrialisation. This process began with the first revised first five-year development plan in 1964, which declared that the Korean government wanted to modernise the country's industrial sectors as well as improve its international competitiveness by supporting key industries such as cement production, fertilisers, industrial machinery, etc. This was followed by the country's second five-year development plan in 1967, which further emphasised heavy and chemical industry (HCI), with particular emphasis on steel, machinery and petrochemical industries. The steel industry was supported through tax exemptions through the introduction of the Steel Industry Promotion Act in 1969; this was followed by similar acts supporting the machinery, shipbuilding, textile and electronics promotion acts (Sakong and Yoh, 2010). The sector also benefited from abundant and cheap surplus labour in the agricultural sector (Park, 2019), which could rapidly move into manufacturing without requiring extensive training.

In tandem with the industrial support acts, the South Korean government carried out significant investments to upgrade infrastructure. This included improvements to electricity provision and road transport networks. By the early 1970s, the government also recognised that it needed to keep up with technological progress in order to maintain the pace of industrialisation. Technology acquisition was initially promoted through two systems: large firms relied on foreign licensing and technical consultancies for the initial installation of production processes; smaller firms developed their own 'primitive' technologies and proceeded down a path of gradual upgrading (Kim, 2003). However, the government recognised the need to promote labour upgrading, hence its focus moved towards the promotion of R&D, technical training for skilled workers and the establishment of local research institutions (Sakong and Yoh, 2010).

The government focus on HCI resulted in two unexpected outcomes. The first was that financial institutions essentially left behind light manufacturing, hence businesses in these sectors were deprived of finance and could not keep pace with the financially facilitated heavy industries. The second was the rise of the *chaebols* – that is, large business conglomerates such as Samsung and Hyundai, which still dominate South Korea's industrial landscape.

Following the assassination of Park Chung Hee in 1979, the 1980s saw a focal shift aimed at improving the competitiveness of extant HCI firms through a process of rationalisation, whereby companies in each sector (i.e. shipping) were merged thanks to a series of fiscal incentives. The process further strengthened existing *chaebols*, which also limited new business entry in strongly dominated sectors. Having recognised its 'failure' to effectively restructure targeted industries, the South Korean government once again shifted its efforts onto the promotion of R&D and financial liberalisation. This process carried on into the 1990s and promoted technological development and greater market openness in South Korea.

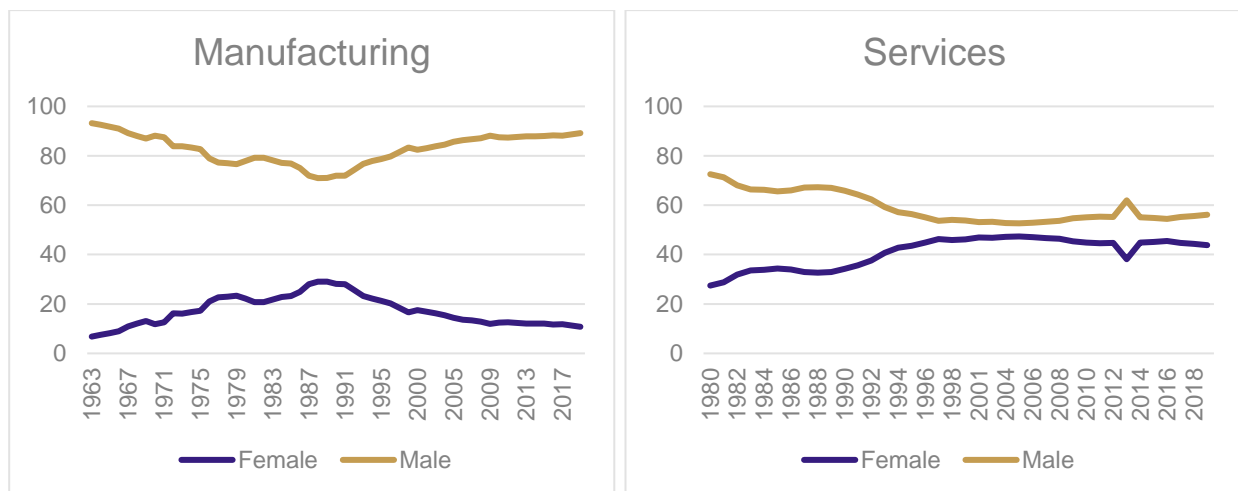
By the 1990s, a new group of Asian countries, including China, was threatening South Korea's economic competitiveness. The South Korean government decided that technological upgrading was the best method to tackle this challenge. This included the promotion of more technologically advanced sectors (such as advanced electronics and information and communication technology (ICT)) and technological upgrading in existing sectors.

Thanks to the R&D focus in the 1980s, the country had access to highly skilled researchers who helped South Korean firms develop their own proprietary advanced technologies. Private firms often conducted joint research with university researchers and also set up their own research institutions. The ICT sector was particularly successful, thanks to government support that began in the late 1990s through implementation of a comprehensive national ICT plan and establishment of the Informatization Promotion Fund in 1996, which provided funding for ICT R&D (Karippacheril et al., 2016). Through significant investment in the country's ICT infrastructure and private sector investments in R&D, South Korea became a world leader in ICT R&D and the manufacture of advanced ICT-focused electronics.

4.2.1 Labour Force Outcomes

The economic transformation of South Korea seems initially to have provided increased opportunities in the manufacturing sector for females, particularly from the mid-1970s to the early 2000s, although this trend has declined. However, in services, gender parity in employment was nearly achieved by the late 1990s and the proportion has been sustained to a large degree up to the present period. The female wage gap has marginally improved, from 58% in 2001 to 62% in 2017 (World Bank, 2019).

Figure 16: Employment in manufacturing and services by gender, South Korea, 1963–2019 (%)



Source: ILOSTAT 2020

Data on South Korean rural employment are quite limited; what is available shows that the proportion of rural employment remained stable at 18% between 2015 and 2019 (ILOSTAT 2020). Even though the rural employment trajectory is not available, it is possible to infer that the economic transformation process has resulted in the push of the majority of the workforce towards urban areas, working in modern productive sectors. Informal employment seems to have accounted for a surprisingly large share of total employment (46%) in 2001, according to the World Bank (Global Jobs Indicator Database (JOIN) 2019); this decreased to 20% by 2017.

4.2.2 Identified Triggers, Enablers, Labour Force and Policy

Based on the above analysis we can identify the triggers, enablers, labour factors and policy processes that contributed to South Korea's economic transformation process

- **Triggers:** The economic reform process was planned and initiated to legitimise the military coup carried out by Park Chung Hee, itself an internal shock event which effectively triggered change in the country.
- **Enablers:** The military coup granted the government a certain degree of strength which allowed it to push through and implement its reform process. The process was maintained through effective state-business relations
- **Labour Force:** Surplus labour in the agricultural sector provided cost-effective labour for the growth of manufacturing in South Korea.
- **Policy:** Multiple policies helped the transformative process in South Korea, such as the export-quotas, liberalisation, targeted support for manufacturing sectors which evolved over time to focus on different sectors as capabilities grew, long-term focus on education and R&D capabilities.

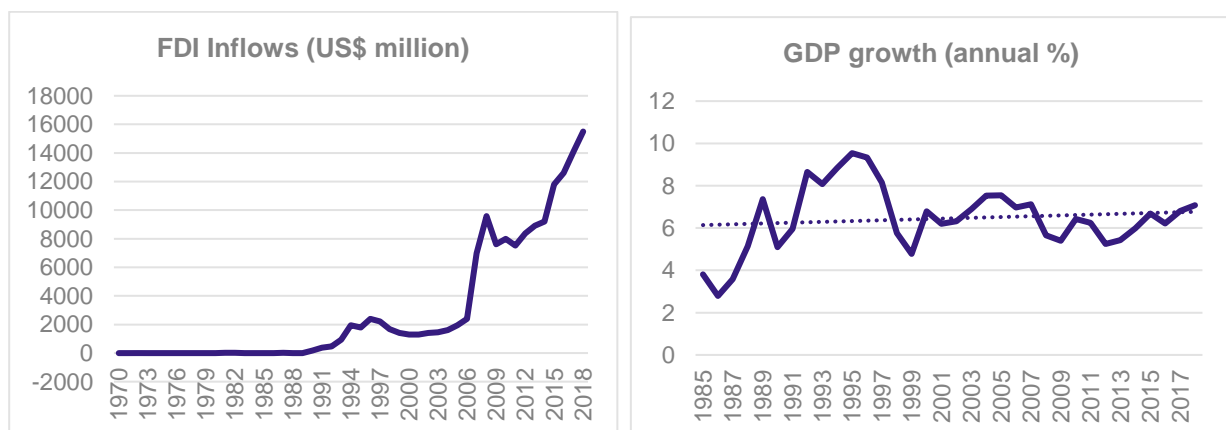
4.3. Vietnam

Following a period of conflict, the Vietnamese economic transformation process began in the 1986 through the gradual implementation of the Doi Moi ('renovation') reforms. Following its independence from France in 1954, the country was partitioned into the socialist North Vietnam (the Democratic Republic of Vietnam) backed by China and South Vietnam (the Republic of Vietnam), which followed a more market-oriented approach and was backed by the US. Subsequently, at the end of the Vietnam War, in 1976, the country was reunified into the Socialist Republic of Vietnam. The Vietnamese Communist Party began the implementation of its second five-year development plan in 1976.⁹ The aim was to reach 16–18% annual growth in the manufacturing sector and approximately 8–10% growth in agriculture. Emphasis was placed on state-owned and collective or cooperative activities rather than privately owned enterprises.

However, inefficiencies in the development process meant that these growth rates were not achieved (Barker and Ungor, 2019). Part of the problem involved structural issues that made Vietnamese state-owned enterprises (SOEs) highly inefficient (price abolition, artificially low labour and subsidised capital inputs), which strongly distorted economic outputs towards highly inefficient manufacturing and starved the agriculture sector of decent inputs. This led to a sharp decline in food production, which was further exacerbated by the removal of Chinese state support in 1978 (following Vietnam's invasion of Cambodia) and increasing levels of foreign debt. An additional component was the soft resistance of the southern Vietnamese to collectivise (particularly in the agriculture sector), which led to a parallel economy in the country, further diverting resources away from 'official' economic activities (Ronnas and Sjoberg, 1991).

Given the relative failure of this initial economic development process, the Vietnamese government embarked on Doi Moi reforms, the main aim of which was the gradual transition from a centrally controlled, closed economy to a more market-oriented and open economy (Le, 2019). A further contributing factor to this change was that the Vietnamese reform process effectively followed on from reforms in other major socialist countries – such as the Chinese reforms in 1976 and the Perestroika ('restructuring') reforms in the Soviet Union in 1985, which fundamentally altered the 'global' soviet trading paradigm under which Vietnam was previously operating. Before the Doi Moi process, Eastern European countries represented 57% of Vietnam's exports, so this operational change was quite significant (Le, 2006). This effectively meant that Vietnam was spurred into reform through both internal and external economic and political pressures.

Figure 17: Vietnamese foreign direct investment inflows and GDP growth, 1970–2017



Source: WDI 2020

⁹ The first five-year development plan began in 1971 and was applied only to North Vietnam.

The first phase of the reform process (1986–1993) focused on opening the country’s economy to international trade, encouraging the growth of the private sector while simultaneously continuing to support state-owned enterprises. The country was opened to foreign investors in 1987, which spurred an influx of foreign direct investment (FDI) (see figure 17 above) from \$0.04 million (nominal) in 1986 to \$15.5 billion in 2018. The first phase saw Vietnam’s sectoral efforts focused mainly on primary products – food, live animals, tobacco, mineral fuels, etc. – while some basic manufactured goods, like lubricants, vegetable oils and beverages, were also exported. The strategy was geared prominently towards the export of agricultural goods (Tarp, 2018) and was laid out in the fourth five-year development plan (1986–1991).

At the same time, there was an effort to reform the agriculture sector through a de-collectivisation effort that granted long-term land right usage to farmers to improve agricultural productivity. This phase also saw exchange rate liberalisation, solidified the private sector and private property rights and allowed the direct import/export of goods by private sector enterprises. This process also helped increase productivity in the agricultural sector which released labour for the Vietnam’s manufacturing sector (Cunningham and Pimhidizai, 2018).

The first phase ended with a number of other policies focused on social reform, granting various rights (such as free information, the right to assembly, freedom of religion, etc.) while reaffirming the central role of the Vietnamese Communist Party as the only political force in the country (Le, 2019).

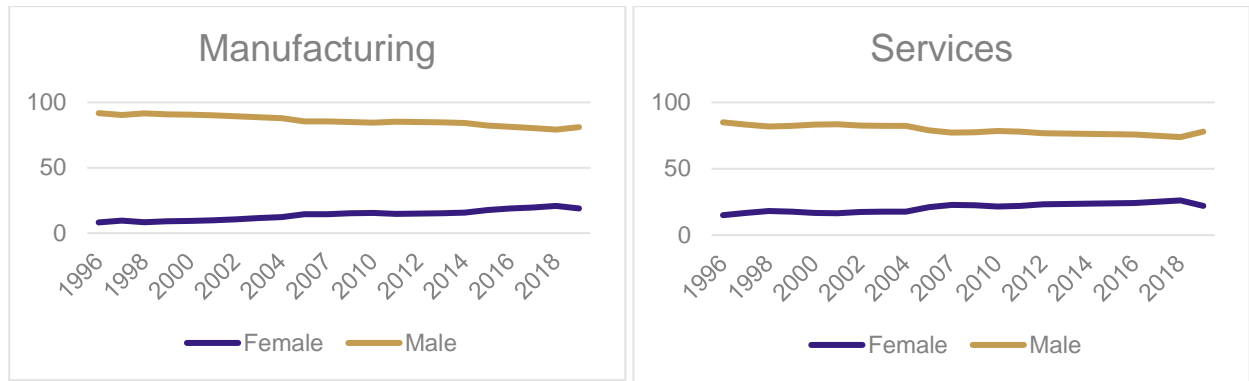
The second phase of the reform process (1994–1997) focused on the one hand on creating new ties to the global economy and on the other on protecting extant industries. Vietnam joined the Association of Southeast Asian Nations (ASEAN), including signing up to its Free Trade Agreement in 1995. At the same time, import bans were imposed on several sectors in the manufacturing sector within the heavy (steel, cement), light (paper) and agro-processing (beer, sugar) industries as a form of protectionism. The result of this deeper global integration was a significant increase in the value of exports in the local economy. In 1986 exports represented 6% of Vietnamese GDP, rising to 30% by 1990, 70% in 2008 and 105% in 2018 (WDI 2020).

The subsequent period continued the global integration process begun in the second phase; however, it also brought challenges, owing to the Asian financial crisis in 1997. Vietnam joined Asia-Pacific Economic Cooperation (APEC) in 1998; however, the impacts of the Asian financial crisis meant that it also had to act to shore up its own industries. It imposed import restrictions while removing extant export restrictions, particularly those that had previously affected foreign-owned firms.¹⁰ In addition, it signed a trade deal with the US, opened up the country’s first stock exchange in Ho Chi Minh City (Le, 2006) and resumed formal relationship with the International Monetary Fund (IMF) and the World Bank (Le, 2019). By 2007, Vietnam had joined the World Trade Organization (WTO), placing it further on the path towards a market-oriented economy.

4.3.1 Labour Force Outcomes

Figure 18: Manufacturing and services employment by gender in Vietnam, 1984–2017 (%)

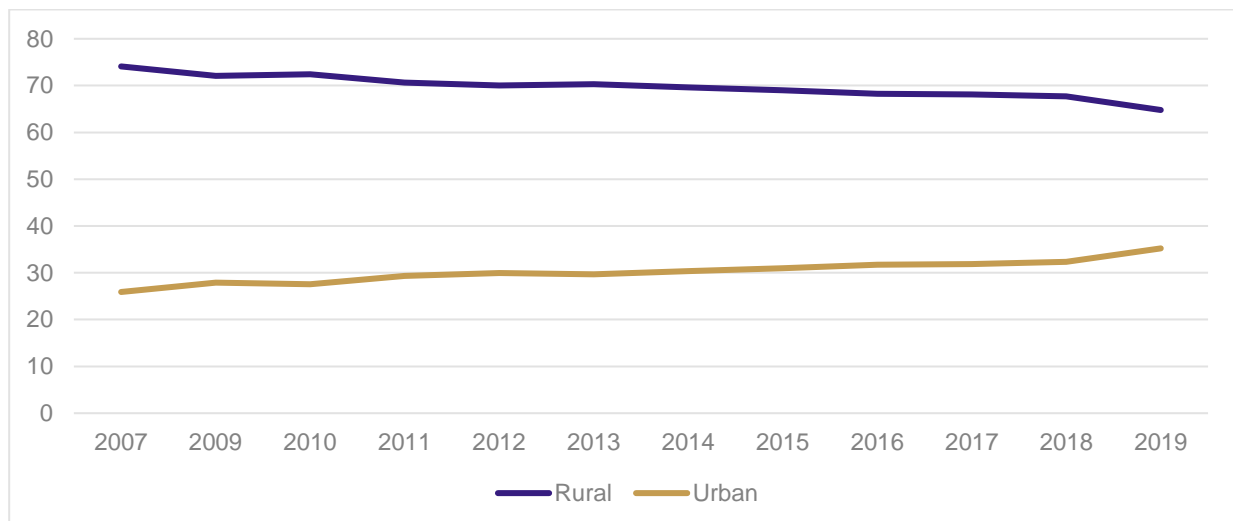
¹⁰ <http://vietnamembassy-usa.org/news/2002/10/decreree-57-31-jul-98-commercial-law>



Source: ILOSTAT 2020

The gender employment outcome of the Vietnamese economic transformation process has been quite weak. Some gains have been made in the manufacturing and services sectors (figure 18 above), but these represent a minimum: a 10% increase for manufacturing and 7% for services. Female wages represented approximately 82% of male wages in 2010 (World Bank, 2019).

Figure 19: Rural/urban employment in Vietnam, 2007–2019 (% of total employment)



Source: ILOSTAT 2020

Vietnam's reform process has not significantly changed the rural and urban employment divide. In 2007, more than 20 years after the Doi Moi reforms began, rural employment still accounted for more than 70% of total employment, although this trend shows an upwards shift in urban employment by about 10% between 2007 and 2019, which indicates that a shift is occurring, albeit at a relatively sedate pace. The limited data available on the informal sector (ILOSTAT 2020) show that approximately 68% of the labour force is informal (69% male and 67% female). This split is likely closely related to the high percentage of workers in rural areas but scarcity of data makes it hard to bestow any ulterior significance on this trend.

4.1.2 Identified Triggers, Enablers, Labour Force and Policy

Based on the above analysis we can identify the triggers, enablers, labour factors and policy processes that contributed to Vietnam's economic transformation process

- **Triggers:** One of the main triggers was the unification of north and south Vietnam into a single communist republic. The second was that the five-year development plans used in North Vietnam were not working for a unified Vietnam, which meant that in conjunction with the withdrawal of Chinese monetary support a new approach was adopted.

- **Enablers:** A strong government provided the capacity to implement the Doi Moi reform agenda and subsequent reform processes.
- **Labour Force:** Increased agricultural productivity allowed labour to move onto other sectors of the economy.
- **Policy:** The Doi Moi process provided a wave of liberalisation and privatisation which was coupled with a movement to internationalise the country's economy initially focussing on agriculture but then moving onto manufacturing.

4.4. Bangladesh

Bangladesh emerged from conflict as an independent, but economically devastated, nation in 1971. Over the next two decades, the Bangladeshi economy slowly recovered but it was only in the 1990s, when the economic reform process began, that the country showed signs of strong stable growth. Over the past four decades, Bangladesh has managed to increase its per capita GDP fourfold. This high growth rate is associated with significant structural changes to the economy (Raihan et al., 2017).

Throughout the 1970s, the Bangladesh government was concerned with rebuilding a post-conflict economy. Since the 1970s, the development strategy and associated economic environment in Bangladesh has undergone successive shifts and transitions, often linked with a change in the ruling political regime. Following the War of Liberation in 1971 and until late 1975, the government's economic strategy was aimed primarily at reviving a war-ravaged economy in an overall framework of extensive state intervention and controls (Ahmed and Sattar, 2004; Mahmud, 2008).

The early to mid-1970s saw the Bangladesh government taking over enterprises that had been abandoned as a result of the independence war and turning them into SOEs, broadly following a socialist ideology in its rebuilding approach. However, in 1975, the country shifted towards a private sector approach, promoting the private sector and privatisation of SOEs. Investment in both public and private capital was spurred on by a combination of foreign aid (leading to the availability of cheap credit) and protectionist policies for domestic industries. This shift towards privatisation and emphasis on private sector promotion emerged under military ruler General Ziaur Rahman, who pursued the path of market privatisation largely as a result of growing pressure from Western powers and the rise of the new capitalist class in Bangladesh (Ahmed and Sattar, 2004).

The late 1970s to the beginning of the 1980s saw a short-lived investment boom in the public and private sector, made possible by an increasing flow of foreign aid, adoption of a privatisation strategy based on lavish dispensation of cheap credit and the provision of other incentives, such as highly protected markets for domestic industries (Mahmud, 2008). These factors, particularly the flow of foreign aid and the dispensing of cheap credit, along with technology transfer from South Korea, can be credited partly for the success of Bangladesh's booming readymade garment sector. The negligible value of Bangladesh's exports at the time meant they were not subject to export restriction under the Multi-Fibre Arrangement (MFA), which attracted the attention of Daewoo Corporation of South Korea, one of the rising garment manufacturers. In an effort to bypass the quota system in South Korea, Daewoo planned to develop a production base in Bangladesh and teamed up with local enterprise Desh Ltd. Desh sent Bangladesh employees to Daewoo's factory in South Korea, where they participated in a diverse training course on skills ranging from sewing to factory management (Mottaleb and Sonobe, 2011). Within a few years, almost all Desh trainees, with the accessibility of cheap credit, had left to start their own garment businesses, bringing Bangladesh its \$2 billion in garment sales in the late 1990s (Rhee, 1990).

Although the investment boom ended abruptly in the early 1980s as a result of the deteriorating aid climate, further denationalisation continued when a second wave of divestment was launched under the military government of General Ershad. Under this ‘Western tilt’ leadership, a major change of direction occurred in the early 1980s with the adoption of a market-oriented development strategy supported by a number of liberalising policy reforms undertaken along the guidelines of the World Bank and the IMF. These reforms were initiated against the background of serious macroeconomic imbalances, which had been caused in part by a decline in foreign aid, as mentioned previously, and by severe deterioration in the country’s terms of trade (Mahmud, 2008). With pressure to undertake structural adjustment policies to reduce the size of its public sector and make its economy more open, Bangladesh enacted the New Industrial Policy of 1982 and began the denationalisation process. A ‘free trade enclave’ was constituted for the emerging readymade garments industry through the introduction of duty-free imports of machinery, bonded warehouse facilities and cash incentives, to name a few (Ahmed and Sattar, 2004). Subsequently, there was significant liberalisation in the import regime of agricultural inputs as well as a withdrawal of food and agricultural subsidies.

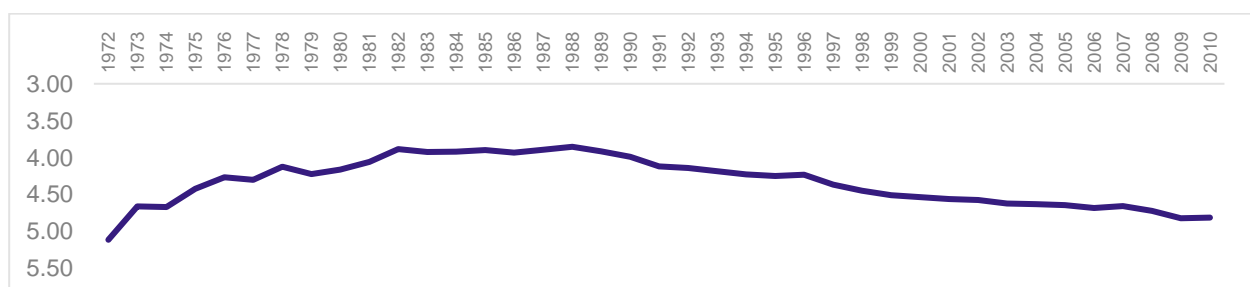
Economic reforms in the 1980s were centred mainly on macroeconomic disciplines (fiscal and monetary restraint) as well as corporatisation of public enterprises. However, macroeconomic reforms were followed by international trade reforms (liberalisation of international trade and currency exchange), which really began to gain momentum in the 1990s.

The 1990s saw the introduction of economic reforms covering a wide range of issues. The early 1990s saw the launch of a more comprehensive programme of macroeconomic reforms, which coincided with a transition to parliamentary democracy from semi-autocratic rule under Ershad (Ahmed and Sattar, 2004). These reforms were aimed at moving towards an open economy and included such measures as making the currency convertible on the current account, reducing import duties and removing virtually all controls on the movement of foreign private capital. Protection of both agricultural and non-agricultural industry declined significantly in the 1990s.

Once again, the driver for these reforms was pressure from Washington, particularly the World Bank Group. For instance, Government of Bangladesh (2001) reports that, ‘Under donor persuasion and the dictates of the Structural Adjustment Program, Bangladesh had brought down its level of public support to agricultural to an absolute minimum.’ Examining the sectoral composition of GDP into the 1990s, the contribution of agriculture to GDP declined from more than 50% in the late 1970s to around 30% in the late 1990s. Interestingly, the share of manufacturing changed very little from 1970 to 1990, hovering about the 10–11% mark.

Of interest is the fact that the rise of the garment sector has skewed Bangladesh’s export basket in such a way as to effectively reduce its export diversification base (see figure 20) since the late 1980s. This has led the country to become particularly vulnerable to global market shocks (such as the global financial crisis of 2008 and the 2019/20 COVID-19 pandemic). As such, even though it has undertaken economic transformation, this is a particularly fragile variety of transformation that may require further efforts by the government to stimulate a diversified export basket.

Figure 20: IMF Export Diversification Index (lower = more diversified), 1972–2010

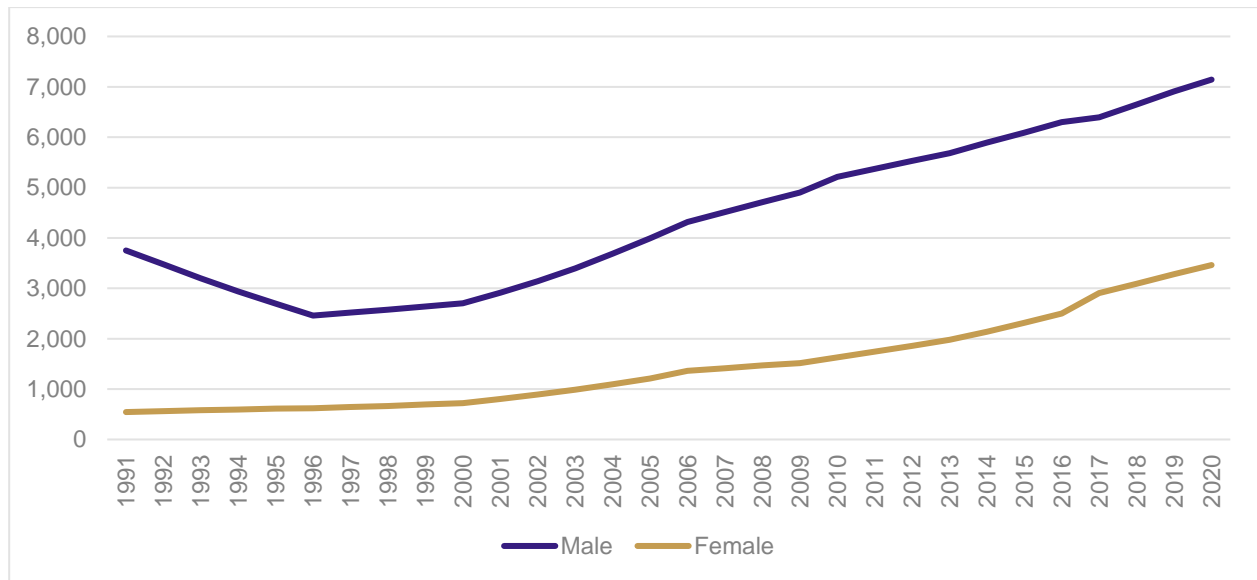


Source: IMF Export Diversification Index 2020

4.4.1 Labour Force Outcomes

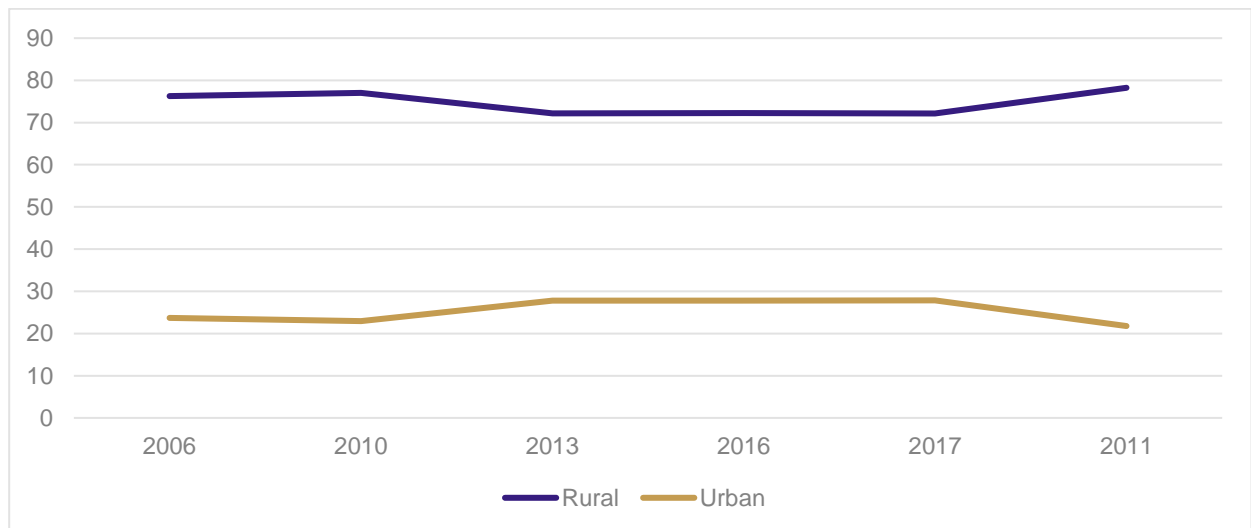
In terms of employment outcomes, there is often-cited discussion on how the manufacturing sector in Bangladesh has improved employment prospects for women; however, figure 21 shows that manufacturing is still male-dominated (68% in 2019). On the other hand, female employment, as a percentage of total manufacturing employment, increased from 12.6% in 1991 to 32.2% in 2019, nearly tripling in share; between 1999 and 2016, the female wage gap improved as females earned 90% of male wages by 2016, compared to 2000 (World Bank, 2019).

Figure 21: Manufacturing employment by gender in Bangladesh, 1984–2017 ('000s of workers)



Source: ILOSTAT 2020

Figure 22: Rural/urban employment in Bangladesh, 2006–2011 (% of total employment)



Source: ILOSTAT 2020

Data on rural employment are limited for Bangladesh; however, for the period 2006–2011, there is no significant evident change in the employment distribution between rural and urban areas. Data for 2015 (World Bank, 2019) place 93% of employment in the informal sector.

4.4.2 Identified Triggers, Enablers, Labour Force and Policy

Based on the above analysis we can identify the triggers, enablers, labour factors and policy processes that contributed to Bangladesh's economic transformation process

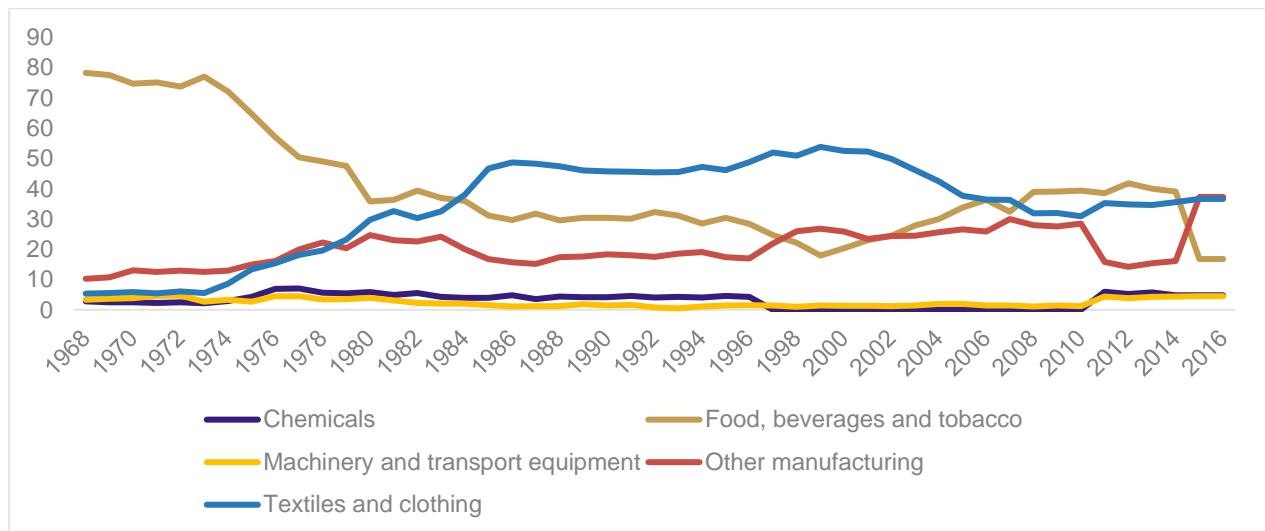
- **Triggers:** The military rule of General Ziar Rahman provided a shift towards a more market led approach to development in the mid-1970s. The establishment of the Daewoo-Desh garment factory subsequently provided the blueprint for the successful establishment of the garment sector in Bangladesh.
- **Enablers:** Horizontal spillovers through the movement of skilled labour, coupled with access to finance enabled the expansion of the garment sector in Bangladesh.
- **Labour Force:** Cheap labour helped the sector gain a comparative advantage in the international market.
- **Policy:** The privatisation movement of the mid 1970's coupled with the promotion of inward FDI helped establish manufacturing in the country.

4.5. Mauritius

Despite its small economic size, shortage of natural resources and vulnerability to exogenous shocks, Mauritius has been able to establish a successful growth-oriented development path and achieve remarkable economic growth. Over the 50 years since independence, Mauritius' successful growth and transition from an agriculture-based economy to a middle-income country can be attributed to a combination of various factors. In particular, adoption of an outward-looking export-oriented strategy has led to diversification of the economy and aggressive policy reforms in the past decade. These have helped maintain Mauritius' resilience to economic shocks – namely, the dismantling of the MFA, the EU sugar reforms and the 2008 financial crisis (Tandrayen-Ragoobur, 2018).

The literature points to several factors that explain Mauritius' successful growth over the past few decades. Ramdoo (2014) proposes that 'economic' transformation of the Mauritian economy was conducted in such a manner that the economic landscape, society and institutions were modernised simultaneously, taking into consideration the political, human, institutional and economic realities and constraints of the time. Drawing from Rostow (1959)'s evolutionist model of country growth phases, the Mauritian development model can be summarised by five distinct phases: the 1970s, when the economy was dominated by sugar cane and the consequent move to manufacturing; the 1980s, dominated by the textile boom; the 1990s, led by tourism and financial services; the 2000s and the advent of ICT/business process outsourcing and real estate; and, finally, in the 2010s, emergence of the ocean economy and Africa strategy (Ramdoo, 2014).

Figure 23: Changes in Mauritius's manufacturing composition, 1968–2016 (% of manufacturing output)



Source: World Bank (2019)

There is consensus among various studies that openness to exports (Rodrik, 1999), FDI (Romer, 1992) and trade policies (Sachs and Warner, 1997) are at the heart of trade being a major contributor to Mauritius' economic growth. Following independence, Mauritius initially tried to adopt an import substitution strategy to curb imports, but policy-makers quickly recognised that an export strategy would be better suited to the small, low-income economy. Key components of this export strategy included the liberalisation of trade policies and exchange rate regimes and allowing inputs to export processing enterprises to enter duty free. Coinciding with this new export-oriented strategy, Mauritius was benefiting from trade policies such as the Sugar Protocol of the Lomé Convention and the MFA, both of which gave the country preferential market treatment for its exports and were key ingredients to the growth and development of Mauritius' sugar and textile sectors (Rodrik, 1997; Tandrayen-Ragoobur, 2018).

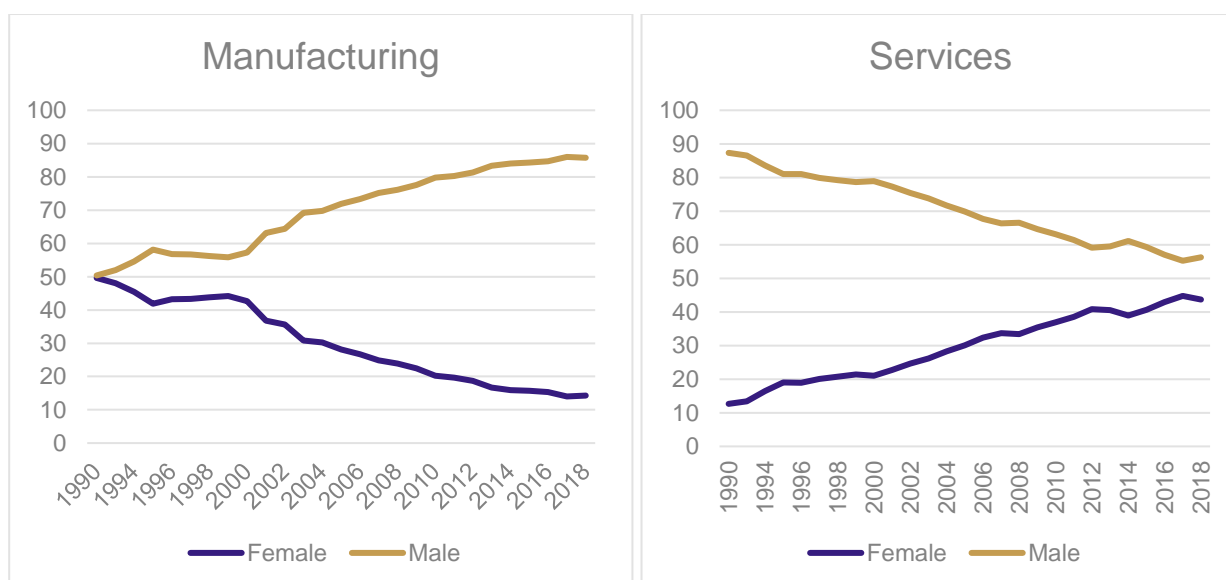
To support this export-oriented strategy and product demand, Mauritius passed the Export Processing Zone Act in 1970 and established EPZs that provided incentives to manufacturers catering to foreign markets. The EPZs were not a delineated geographic area as in other countries but were effectively licences granted to firms on the island that wanted to export. Key components of the legislation included duty-free inputs for manufactured exports, which was key to expanding Mauritius' export competitiveness in world markets; tax incentives provided to the export firms helped subsidise exports; firms in the EPZs benefited from availability of cheap labour; and lower wages paid to workers allowed the firms to accumulate capital and reinvest the earnings into the firms' expansion (Tandrayen-Ragoobur, 2018). By the 1980s, EPZs accounted for more than 60% of Mauritius gross export earnings and employed a third of the labour force. In terms of share of GDP, goods produced in EPZs more than tripled between 1980 and 1988, from 4% to 14% (Zafar, 2011).

Mauritius' ability to diversify its economy is directly linked to the success the country had from exports of sugar that generated wealth, which the private sector then used to diversify activities into textile, tourism and financial services. An important driver of the economic transformation processes has been the effective state-business relations that the varied governments of Mauritius have managed to maintain throughout the decades. An important aspect in maintaining good state-business relations has been the institutional setup in the country. The government has created a number of strong representative bodies, both economy-wide and sector-specific, which help maintain dialogue (and seek consent) between the state and the private sector (Rojid et al., 2010). The institutional setup also benefits from a certain degree of dynamism and capacity to adapt to evolving circumstances, which helps policy-makers adapt for the future rather than wait for economic shocks (Zafar, 2011).

Mauritius is an example of an economy that has undergone successful structural transformation and serves as a lesson for other countries similarly transitioning from agriculture to manufacturing and services. Tandrayen-Ragoobur (2018) examines the Mauritian structural economic transformation process starting in the mid-1970s. Since 1976, the share of the primary sector in GDP has declined substantially, primarily because of the contraction of the sugar industry following the end of the EU Sugar Protocol. To combat this decline, reforms under the Multi Annual Adaptation Strategy were implemented to reduce costs, enhance competitiveness and diversify into high value-added activities, such as the production of special sugars, ethanol and spirits. The share of secondary sector output rose to 31.4% in 1986 but had fallen to 19.2% in 2015. This is closely linked to the decline of the EPZ sector along with the end of the MFA, with the closure of textile factories, increased labour costs and rising competitive pressures from other countries like China and Bangladesh. The share of the tertiary sector in GDP saw a steady increase from 52.3% in 1976 to around 77% in 2015, largely because of the expansion of sectors like tourism, financial and business services and ICT.

4.5.1 Labour Force Outcomes

Figure 24: Manufacturing and services employment by gender in Mauritius, 1990–2018 (%)



Source: ILOSTAT 2020

One major lesson from Mauritius for other countries lies in the country's ability to identify the major turning points of the various stages of structural transformation: agriculture to manufacturing and to services. However, in terms of the employment outcome of the transformative process, female representation in the manufacturing sector declined significantly from 1990, from a position of (approximate) parity to one where the sector is male-dominated. The reverse is true for the services sector, which was male-dominated in 1990 but had achieved near gender parity by 2018. Data on the urban/rural employment divide were not available for Mauritius,¹¹ nor were data on informality.

4.5.2 Identified Triggers, Enablers, Labour Force and Policy

Based on the above analysis we can identify the triggers, enablers, labour factors and policy processes that contributed to Mauritius's economic transformation process

¹¹ Including in the official labour statistics yearbook or within the World Bank JOIN database

- **Triggers:** The Mauritius government took a planned pragmatic approach to its economic development, recognising that import-substitution would not work with such a small economy, rather focussing on export promotion. The move from agricultural exports into manufacturing and eventually services was effectively triggered by the conclusion of the EU Sugar Protocol, which previously provided a comparative advantage for sugar exports from the country.
- **Enablers:** A capable civil service helped the Mauritius government understand that import-substitution would not work, leading towards the path of export promotion. In addition, good state-business relations and effective institutions helped the government identify promising sectors and resolve roadblocks towards their development.
- **Labour Force:** Given the small size of the country's labour force, the move towards higher value manufacturing and eventually services meant that the country would have to focus on higher-productivity employment in order to drive long-term growth.
- **Policy:** The export promotion policy was a significant driver which was coupled with policy flexibility that allowed the government to drive and sustain the transformative process.

4.6. Sri Lanka

Sri Lanka is the final country, and the section below is a summary of a separate case study document (Wignaraja and Huttemann, 2020) specifically looking at the economic transformation pathway that the country has engaged in.

Sri Lanka is sometimes cited as an example of successful economic transformation and employment creation in South Asia. The trigger for economic transformation was the shift in its national economic strategy, moving away from import substitution industrialisation policies towards an international export-oriented trade strategy in 1977.

Even though the country was the first South Asian economy to liberalise its economy to trade and FDI, a nearly 30-year civil conflict that began in 1983 and ended in 2009 hindered the process of economic transformation. Despite this significant setback, Sri Lanka did experience a shift away from domestic agriculture to industrial and services sector activities, which was accompanied by sectoral shifts in employment from agriculture into industry and services. Concurrently, the country saw a shift away from import substitution into export-oriented manufacturing, while services increased in importance to rapidly represent nearly half of exports by the late 2010s.

Between 1981 and 2000, the share of goods increased from 79% of exports to 85%, while services increased from 14% in 2000 to 41.3% in 2018. The growth in manufactured exports that lasted until the year 2000 was driven by the garment sector. The sector became significantly important in the 1980s and 1990s and increased its share of exports from 1.9% in 1977 to 47% in 2000, when it reached its peak. In absolute terms, the sector exhibited continuous growth even after 2000 as exports grew by nearly 100% between 2002 and 2015 and employment also continued to grow, representing 7.3% of total national employment by 2015. However, in relative terms, its GDP contribution fell from 4.4% in 2002 to 3.7% in 2015, while its share of exports fell from 41% to 28% over the same period.

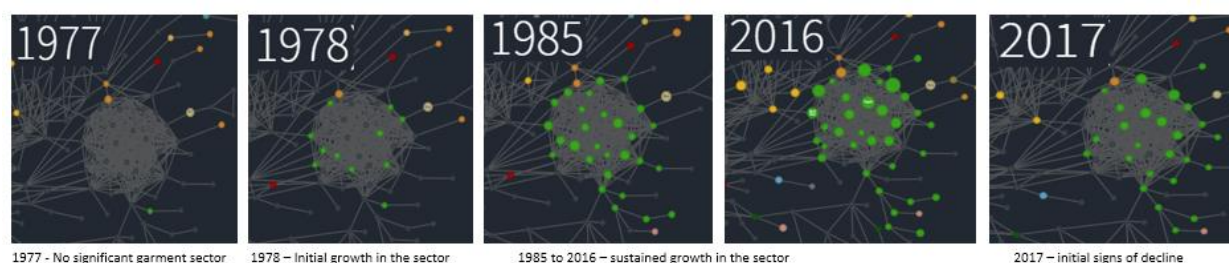
The garment's sector growth is attributed to three main policy phases. The first was a period of economic liberalisation that began in 1977 and lasted until 1990, which pushed the country towards an export-oriented economy. This was coupled with a few facilitating external factors such as developing country status and preferential terms of trade under the MFA in 1974. Export-oriented FDI, which the country encouraged by relaxing previously stringent foreign investment

laws and setting up EPZs, was a significant driver of growth, particularly for the garment sector during this period.

The second phase, between 1990 and 2005, entailed extensive government support. The 200 Garment Factories Programme, begun in 1992, provided significant incentives for FDI to set up garment factories in rural areas of the country. Although the programme faced some challenges, by 1995, it had resulted in the creation of approximately 163 factories in rural areas.

The third phase was a period of consolidation and outward-oriented FDI that began in 2005. The expiry of the MFA and its successor, the Agreement on Textiles and Clothing in 2005, reduced the comparative advantage from which the garment sector had benefited, hence the sector began a period of consolidation. This change is evident in the product complexity map in figure 25 that highlights the evolution of the garment sector from the late 1970s to the late 2010s, when the initial decline in the types and quantity of garment products exported become evident. However, the country's service exports began to rise in prominence.

Figure 25: Changes in Sri Lanka's garment sector, 1977–2017, through the Product Space Map



Source: Observatory of Economic Complexity country data 2020

Sri Lanka's tourism was relatively underdeveloped as a result of the civil war; however, tourism picked up from 2009 onwards as international arrivals began to increase substantially. Employment in the sector grew at 15% per year and by 2018 the sector accounted for 5% of total national employment and had become the country's third most important source of foreign exchange, accounting for 52% of total service exports and 22% of total exports. FDI in the sector increased from \$6 million in 2009 to \$182 million in 2015. The government set up a number of policies aimed at strengthening the sector after 2009, mainly through implementation of its Tourism Development Strategy in 2011, an FDI facilitating 'one-stop shop' office, tax incentives and simplifications, investments in infrastructure and international tourism campaigns. However, there have been some challenges in the sector: the 2004 tsunami provided an initial setback and the 2019 Easter bombing also negatively affected tourism inflows. Infrastructure remains below sectoral requirements and limits positive spillover effects into other sectors of the country's economy.

A new services sector has begun to gain traction. There has been a significant rise in the country's ICT and business process management (BPM) sectors. By 2016, the this sector had become the third highest contributor to services value-added and exhibited a rapid rise in employment, from less than 20,000 workers in 2003 to approximately 125,000 in 2018, accounting for 1.6% total employment and 3.4% of services sector employment. The sector has created important national links to other sectors such as agriculture, engineering, health care and logistics, and it is estimated that every job in ICT/BPM indirectly supports 2.5 jobs in the remainder of the economy. ICT's share of total exports increased from 0.7% in 2000 to 4.9% in 2018.

The sector benefits from relatively low labour costs coupled with a high-skilled workforce, with approximately 85% of workers attaining an undergraduate degree. However, demand for workers is not as high as in India or the Philippines, which has kept wages relatively low. ICT enabling service costs, such as broadband, are also relatively lower than in neighbouring countries. Initially,

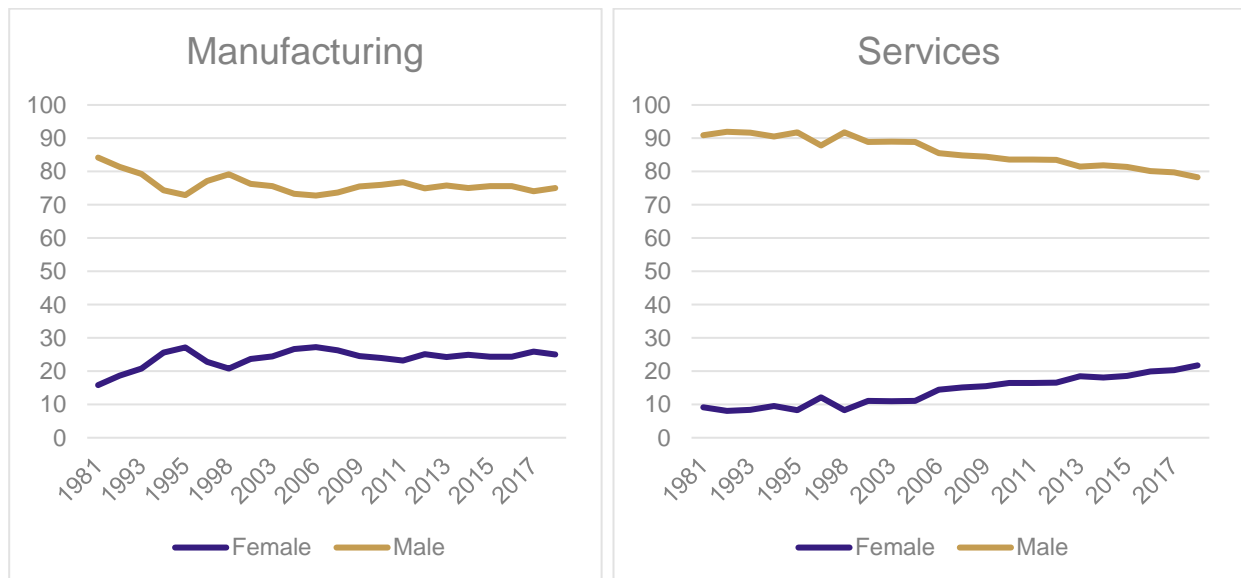
the sector benefited from liberalisation of the telecommunication sector in 1996, abolishing the government monopoly. The sector has also benefited from government support, which has identified the sector as a major driver for growth and investment in its 2018–2022 National Export Strategy. In 2002, the government launched the e-Sri Lanka initiative and ICT Development Roadmap in collaboration with the World Bank, while providing numerous legal and fiscal reforms and incentives to support the sector, for example the abolishment of corporate taxes for IT and IT-enabled services in 2020.

A combination of various factors has triggered sectoral development in Sri Lanka, including targeted government policies, collaborative efforts between public and private sector participants and increasing international recognition of Sri Lanka as a manufacturing, outsourcing and tourism destination. In addition, the development of Sri Lanka's garment sector has been influenced by key politicians such as former Finance Minister Ronnie de Mel and President Ranasinghe Premadasa, whose targeted policies have been complemented by private sector efforts, particularly those of Martin Trust – a key figure for the modernisation of Sri Lanka's garment sector.

4.6.1 Labour Force Outcomes

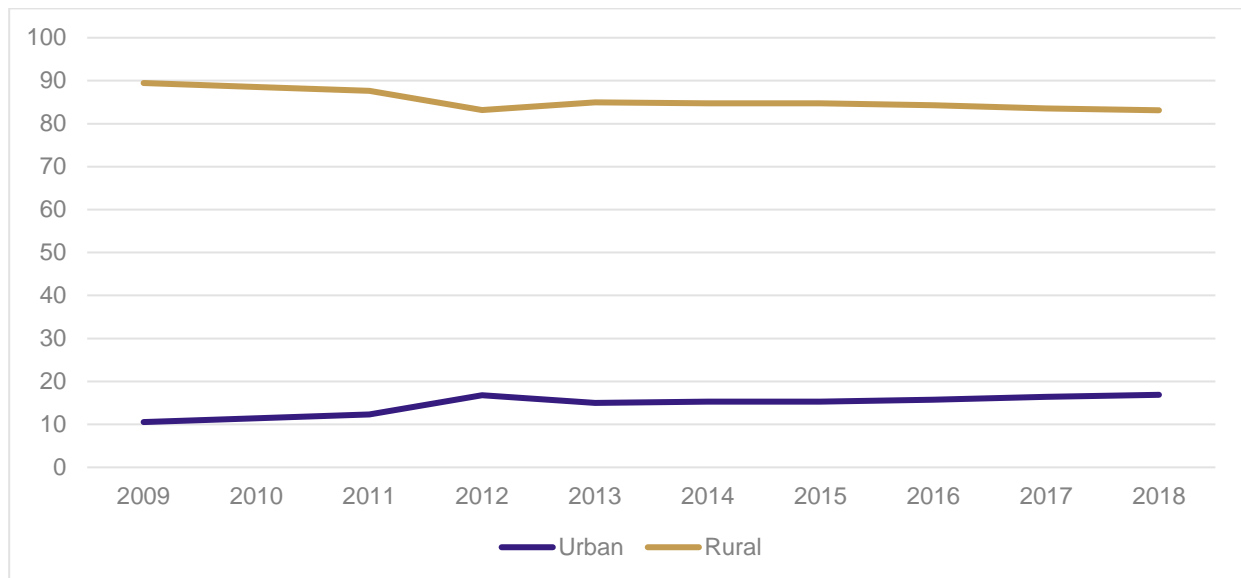
The country has shifted from an agricultural to a labour-intensive manufacturing and society then into a more services sector-based economy. The gender employment outcomes of the transformative process are not particularly evident, however. Female participation has increased in both the manufacturing and services sectors, but by only around 10% for each sector over approximately four decades.

Figure 26: Manufacturing and services employment by gender in Sri Lanka, 1981–2018 (%)



Source: ILOSTAT 2020

Figure 27: Rural/urban employment in Sri Lanka, 2009–2018 (% of total employment)



Source: ILOSTAT 2020

The country's informal employment accounted for 62% of total employment in 2009 (ILOSTAT 2020), with 65% of males and 56% of females working informally. This means that, even though economic transformation has occurred to some degree, informal employment is still an important aspect of the economy. The gender wage gap has seen a decrease in female pay, as females were earning approximately 84% of male wages in 1992 down to 75% in 2015 (World Bank, 2019).

Finally, the rural/urban employment divide shows that, by 2009, rural employment was still dominant (approximately 90% of total employment), and the trend had barely changed by 2018, decreasing by less than 10%. Given the importance of the tourism sector (which occurs mainly outside major urban centres) and the push by the government to locate manufacturing plants in rural areas, this division could be interpreted as a success. However, in 2018, mean urban wages were approximately 27% higher (Government of Sri Lanka, 2019) than mean rural wages; hence, higher-productivity and, therefore, higher-income jobs have likely not yet fully penetrated the Sri Lankan rural economy.

4.6.2 Identified Triggers, Enablers, Labour Force and Policy

Based on the above analysis we can identify the triggers, enablers, labour factors and policy processes that contributed to Sri Lanka's economic transformation process

- **Triggers:** The end of Sri Lanka's civil war in 2009 effectively allowed the government to once-again focus on economic development, although it had already engaged in the transformative process since the implementation of an export-orientated development strategy in 1977. In addition, the implementation of the multi-fibre agreement in 1974 allowed the country's garment sector to increase its export capabilities and grow.
- **Enablers:** The entrepreneurship capabilities generated within the garment sector helped it to upgrade along the global value chain, producing greater value garments rather than limiting the sector to the lower end of the scale. Effective state-business collaboration facilitated this process as well as help identify additional sectors for development, such as tourism and ICT.
- **Labour Force:** The initial movement of labour from agriculture into garments helped set the manufacturing sector gain traction. More recently, the country's recent move into ICT

was facilitated by a high skilled and educated workforce which allowed it to enter in this market.

- **Policy:** Privatisation and liberalisation policies were coupled with export promotion and the promotion of export orientated FDI to help grow the country's manufacturing sector.

5. DRIVERS OF ECONOMIC TRANSFORMATION

This section uses Sections 3 and 4 to understand the potential drivers and triggers of economic transformation. There are pull and push factors that have facilitated economic transformation for each country that are country-specific. These factors were likely a combination of internal (e.g. government policy, internal conflict) and external (e.g. regional conflict, changes in trade agreements) factors that pushed a country towards its economic transformation pathway.

Even though these triggers, at the country level, are context-specific, the paper attempts to distil these to understand the potential common denominators in the countries that have exhibited economic transformation.

Triggers are the events that kick-start the transformative process:

- **Shock events:** Several economic transformation processes began as a result of what could be defined as 'shock events', which triggered changes in either political or economic circumstances, causing a chain reaction within the country. These shocks can be either external or internal. For example, the collapse of the Soviet trading bloc and conflict with China pushed Vietnam to adopt an increasingly outward-looking economic strategy and were contributing factors in the Doi Moi reforms. Reforms in South Korea occurred as a result of the military coup by Park Chung Hee.
- **External influences:** In addition to (relatively) unforeseeable external factors, countries that undertook economic transformation reforms either took advantage of advantageous external conditions or may have been influenced by external agents of change. Sri Lanka's government sector grew thanks to the MFA; Bangladesh's economic reforms were carried out thanks (in part) to pressure by the World Bank; and the end of the EU Sugar Protocol spurred Mauritius to move away from sugar as one of its main exports into garments and eventually into tourism and financial service exports.
- **Planned change:** The process of reform may be triggered by deliberate political decisions that set a country out on the pathway to economic transformation – for example five-year development plans. The Chinese reform process was a deliberate choice made by the government to reduce the vulnerabilities created by the previous single-figure authoritarian regime of Mao Zedong. Park Chung Hee's government decided to undertake reforms in order to legitimise the military coup. Vietnam's revolutionary Doi Moi reform process was spurred on by the failure of previous five-year development plans, which made it consider a different approach.

Enablers are the factors that sustain the transformative process:

- **Strong government:** The drive to reform a country requires a strong, capable government with a capable civil service that can enact its development vision. There is no doubt that some of the most successful countries had strong governments (China, Vietnam and South Korea). Reforms require sustained pressure and broad consensus-building, which would not be possible under weak government control. Collaborations across political divides are crucial to maintain long-term momentum. Hence, questions remain on how weaker forms of government in developing countries promote the economic transformation process.

- **Capable civil servants:** A significant number of economic transformation processes were successful as a result of strong capabilities in government institutions – that is, the capacity of governments to base policy choices on reputable knowledge and expertise. This means that changes are based on real needs and policy is based on evidence-backed recommendation. This reduces the capacity for dysfunctional politics to dilute the strength of successful transformative reform processes. Examples include the Mauritian government’s understanding that import substitutions would not work in a small island state, China’s use of economic experts to set out its EPZ programme, etc. Capable institutions also have the understanding and capacity to foster nationwide consensus-building for necessary reform programmes.
- **State–business relations:** Ensuring that private enterprise is part of the reform process helps the government support transformative sectors with growth potential. It also allows the government to understand what types of policies it should promote and what investments (i.e. in infrastructure) it should carry out. The South Korean government set up a strong formal state–business collaboration process, which benefited from the presence of top-level government officials giving it the agility and authority to carry out required policy changes.
- **Evolving Institutions:** An important aspect of the transformative process is the capacity for institutions to improve their capabilities and evolve to keep up with constantly changing requirements. Government institutions improved their capabilities (i.e. in China, Sri Lanka, South Korea) to better carry out their functions and support effective policy making and state-business processes. Governments looking to transform therefore need to promote growth in skills, capabilities (and often political power) in their relevant institutions if they seek a successful process of economic transformation.
- **Entrepreneurship:** Closely linked to the privatisation process, the entrepreneurial capabilities of a country’s private sector can influence its transformative trajectory. Examples include the vertical upgrading of the garment sector along global value chains in Sri Lanka and horizontal spillovers through the movement of skilled labour between garment factories, allowing the creation of new garment firms in Bangladesh. Strong entrepreneurial capabilities also allow firms to help the government understand what their growth needs are. In addition, it helps firms understand what opportunities there are to upgrade along a value chain or diversify into different products – both important components of the economic transformation process.
- **Labour force:** The composition of a country’s labour force can be an important driver of the economic transformation process.
 - **Labour supply:** Transformative sectors require workers. Initial stage transformative sectors such as lower-value manufacturing can benefit from an existing labour force that is being either pushed away from agriculture as its labour productivity increases or pulled into manufacturing because wages in manufacturing are higher than those in agriculture. This was the case in China, which could offer FDI that was setting up shop in SEZs a steady stream of labour to work in manufacturing plants.
 - **Labour costs:** Lower labour costs can attract FDI in labour-intensive manufacturing sectors, promoting the growth of such sectors. For example, the garment sector of Bangladesh benefited from abundant cheap labour relative to some of its neighbouring countries.

- **Labour skills:** Where labour is skilled, it can promote growth sectors. For example, ICT skills in Sri Lanka are allowing the sector to grow while its skilled garment workforce allows garment firms to create higher-value products.

Policy shapes the transformative process:

- **Policy support:** Government policy support is fundamental in order to promote the economic transformation process. This section has already presented several examples, although it is important to distinguish between general policy support and more targeted support, as each one contributes differently to the economic transformation process.
 - **General support:** This section refers to numerous examples of general public policy support that transformative countries have undertaken to foster the economic transformation process – for example general economic liberalisation policies through the Doi Moi in Vietnam and the liberalisation of key parts of the private sector in China.
 - **Targeted support:** Transformative countries have also made use of targeted public policy support to develop specific, transformative, sectors within the economy – for example export quotas and the focus on different sectors through time in South Korea. Targeted support also allows for the implementation of small-scale transformation support where governments do not have the capacity to sustain transformative policies at the national scale – for example targeted infrastructure investment and SEZs in China.
- **Privatisation:** In parallel with internationalisation, most economic transformation reforms see a process of privatisation, particularly for centrally controlled countries where the private sector has been either removed or repressed in some form. China's reforms in allowing greater control over private sector activities, as well as Sri Lanka's and Vietnam's liberalisation of the private sector, were fundamental drivers of the transformative process, allowing FDI into the country and promoting growth for domestic firms.
- **Agriculture:** An important step, particularly for low income countries, is driving up the level of agricultural productivity. This not only provides a stable food production base, more importantly it frees up labour that can be moved to other higher productivity sectors like manufacturing. China and Vietnam both reformed their agricultural sectors through a series of liberalisation and partial privatisation policies which helped increase labour productivity in the sector. This freed up labour to move into higher value manufacturing production. In addition, agricultural products can also contribute to a country's export basket and the initial stages of an export promotion process i.e. in Mauritius.
- **Manufacturing:** There is no doubt that all the countries that underwent economic transformation did so by promoting their manufacturing sector. In each case, the sector received support from the government and was used as the springboard for future growth within the sector (including vertical upgrading and horizontal diversification), as a major source of productive employment and an eventual driver of innovation. Its growth was also useful to grow interlinked services sectors (such as ICT and finance) and provide transferable skills to the workforce.
- **Internationalisation:** All the example countries exhibited one common trait: the internationalisation of their economy. China aggressively sought out FDI through its SEZs, South Korea's reform strategy was based on export promotion and industrialisation, Vietnam opened up to FDI in 1987, Mauritius shifted towards exports and Bangladesh's garment sector was effectively set up through FDI and learning from foreign firms. The internationalisation effort is usually an ongoing process. For example, China eventually

joined the WTO, which required further reforms; Vietnam similarly joined ASEAN, APEC and eventually the WTO.

- **Education and R&D:** The countries that have continued to sustain economic transformation are those that have invested in their capability to innovate. Long-term educational policies, pushing people towards higher education coupled with strong support to domestic research and development capabilities, have allowed countries such as China and South Korea (as well as additional examples such as Japan) not only to catch up to developed countries in terms of innovation but also to become world leaders in the technological innovation process, spurring the growth of high-value manufacturing and ancillary high-value services (such as ICT and finance).

6. CONCLUSIONS

This paper has discussed the driving forces of economic transformational pathways. It has looked at how to measure economic transformation and provided empirical examples of these pathways. It finds six countries that have exhibited particularly successful economic transformation pathways compared with the developing country average across a range of relevant measures. The paper also discusses the potential factors behind the process of economic transformation across the six comparator countries. From these, the paper has identified factors that have contributed to economic transformation.

Economic transformation is an iterative, long-term, process. The main economic reform pushes in China, South Korea and Vietnam, for example, were not single events that occurred independently in the countries in which they were implemented. They were often based on either previous attempts to reform (e.g. in Vietnam), built on existing reform processes (e.g. agricultural reform in China) or occurring over a sustained period of time (e.g. in South Korea). Countries looking to reform should not expect the reform process to be a one-time event but need to understand both what reforms have succeeded (and failed) in the past and that the process will require sustained support to maintain successful initiatives (i.e. the long-term promotion of education and R&D), as well as the flexibility to carry out significant adjustments to policy over time (i.e. shifting the focus of support from manufacturing into higher-value services).

Shocks can trigger change. Shock events can act as a springboard for change for countries that may be in a period of stagnation and require change, thus governments should be agile enough to take advantage of such opportunities if they occur. The COVID-19 pandemic is one such event that could push countries to re-evaluate their production systems and push for an economic transformation agenda that could result in more sustainable and robust national economies. It is important to note that these shock events usually occur following the conjunction of international and/or domestic circumstances. For example, the military coup in South Korea was, in part, the result of its previous civil war. In addition, they are not part of the usual country governance process, hence cannot (and, in the case of violent conflict, should not) be triggered at will in order to push for reforms.

Pragmatism can set the pace of change. China's dual-track approach was a pragmatic choice to maintain some form of distortionary market support in some sectors and initial market liberalisation in other sectors in order to protect potential losers in the reform process. South Korea also mixed protectionist policies such as import quotas with liberalisation policies, gradually moving towards full liberalisation as its sectors grew in strength and could compete in the global marketplace. Mauritius decided to set aside its import substitution policies because it did not have a large enough market to justify these. These pragmatic choices can help countries set their own transformative pace and also ensure that sectors or stakeholders that may lose out on the transformative process have ample time to adjust.

Expertise in government is fundamental. The reforms in China and South Korea were facilitated by the significant use of experts in the economic planning process in both countries. Policy was led by expertise and not by politics. This may, however, require some form of long-term political stability – but it does not necessarily mean that authoritarian regimes are required to enact these policies if there is an understanding between political parties to maintain reform processes and continued backing to successful initiatives.

Export orientated manufacturing is the springboard of the transformative process. However, the process starts by improving agricultural productivity, moving to lower value manufacturing and only moving into higher value goods as capabilities improve. All successful transformers used the manufacturing sector as a springboard to launch their economic transformation process, after improving the productivity of their agricultural sector (i.e. in China and Vietnam) in order to free up labour for their manufacturing sectors. South Korea, Mauritius,

Vietnam, Bangladesh, Sri Lanka and China all used their manufacturing sectors to drive the initial stages of the economic transformation process. The countries invariably started with the production of lower value goods which required limited knowledge and capabilities, eventually moving into higher value goods as skills, knowledge and R&D capabilities were built up, rather than attempting to leverage non-existent skills by moving straight into higher value goods production. The goods produced by the manufacturing sector were geared towards the export market, supported by general liberalisation and privatisation policies as well as more targeted policies such as export quotas (for larger countries such as South Korea) as well as intensive but localised support (which meant that manufacturing sector support could be concentrated and not diffused) such as through SEZs in China.

Manufacturing development supports higher-value services. Those countries that have sustained the economic transformation process have done so by adjusting their focus to include high-value services both as an export (e.g. tourism) and as a way to build up internal expertise and to support extant sectors such as manufacturing. The service sector builds on the needs of the manufacturing sector; hence it is critical to initially develop a manufacturing sector that requires higher value services such as R&D, telecommunications and financial services. This requires a build-up of an educated and skilled workforce and additional liberalisation policies (e.g. in finance and telecommunications).

Not all forms of economic transformation result in robust economic systems. In Bangladesh, the rise of the garment sector has helped the country transform by promoting the growth of the manufacturing sector. However, manufacturing is dominated by garments, which has resulted in a less diversified economy. Such an outcome (i) creates significant vulnerabilities to economic shocks that affect the dominant sector and (ii) reduces the country's capabilities to expand into other manufacturing sectors, limiting its economic complexity capabilities. This is not a dead-end process; however, countries need to recognise the need to diversify production and should promote tangential sectors that could help increase the diversification of output.

Societal divisions in employment remain. With exceptions, the transformative process has not equally reached all country populations in terms of employment opportunities. Females are still underrepresented in modern sectors such as manufacturing, and, in most countries, employment is still mainly found in rural areas. This suggests that traditional sectors still dominate, particularly when taking into consideration the high level of informality that persists in some countries.

Knowledge gaps persist. The research has uncovered some notable knowledge gaps and further evidence would be useful. For example, it is unclear how governments have dealt with any eventual (and inevitable) 'losers' within the economic transformation process, particularly for sections of the labour force that could not gain employment in growth sectors, and how they have handled opposition (e.g. business lobbies) within sectors that no longer receive state support or state protection. Additional information on the structure of the informal sector as well as on the structure of rural employment (particularly by sector) would be of great benefit to future evidenced-backed policy-making.

Sequencing matters. The issue of sequencing is important. The case studies show that transformation occurs through a sequence of events. The process usually begins with a 'shock' that alters the in-country dynamics, allowing more progressive governments to begin a planning process, accompanied by a strengthening of government capabilities and laying down the foundation for a more competitive labour force (education, skills). The countries initially targeted export-oriented manufacturing through small-scale initiatives such as SEZs, later scaled up to the national level. In parallel, the foundations for future growth were laid through business environment reforms, organising effective state-business relations and long-sighted investments in R&D. These bases, combined with government adaptability, were fundamental for high-growth countries to sustain the transformation process, as they allowed them to move into high-technology goods and high-value services.

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ANNEX 1

Table A1: Summary table of economic transformation indicators used

Measure	Use	Data required (and potential sources)
Sectoral contributions to GDP or employment for industry and manufacturing.	Analysing production or employment structures at the sectoral level and if/how they change over time Helps understand how output/ employment is divided between sectors and to identify scope for shifting resources from low- to higher value-added sectors	Disaggregated output and employment data WDI 2019
Labour productivity (output/value added per worker)	Tracking changes (growth) in productivity Can be used to measure <i>both</i> within- and between-sector components of productivity change; and productivity gaps across sectors Value-added per worker can be measured in alternative ways Provides an alternative, less data-intensive, measure to total factor productivity	Calculated using data on gross value-added and employment by sector SET 2019 based on ILOSTAT 2019 and UNdata 2019
Productivity decompositions	Decomposing total annual labour productivity change into the shares owing to within-sector productivity change and structural changes Helps identify whether structural change is taking place and determine the extent to which productivity changes are driven by structural change (between sectors) or productivity growth (within sectors)	Calculated using data on GDP and employment by sector SET 2019 based on ILOSTAT 2019 and UNdata 2019
Export diversification	Examining changes in the diversification of a country's export base. Provides an alternative way to examine economic transformation without requiring productivity data or sectorally disaggregated data on output and employment	Disaggregated trade data; data limited to 2010 IMF Export Diversification Index 2020
Economic complexity	Assessing changes in productive capacity based on export data Helps understand if the country is capable of making more complex products and can be compared across discrete timepoints to assess changes in productive capacity	Based on export trade data Observatory of Economic Complexity 2019

Source: set.odi.org

Table A2: Summary table of economic transformation pathways through an empirical lens

Measure		China	Bangladesh	Vietnam	Mauritius	Sri Lanka	South Korea
Does the country exhibit structural transformation?	Industry (GDP)	Increase from early 1970s to early 1980s and between late 1980s and mid 2010s	Rapid growth from 1972 onwards	Growth from 1990 to early 2000s	Decline from mid-1990s onwards	Growth from late 1960s to early 1980s	Rapid increase between 1960 and late 1980s
	Manufacturing (GDP)	Data available only from 2005. Highest rate of manufacturing in GDP	Rapid growth from early 1970s	Recovery period from early 1990s	Growth between mid-1980s and late 1990s	Recovery from early 2000s	Sustained growth from 1960s until late 2010s.
	Services (GDP)	Sustained growth from early 1980s	Sustained growth from early 1980s	Erratic growth from mid-1990s	Sustained growth from mid-1980s	Sustained growth from early 1980s	Sustained growth from mid-1960s
Are there changes in the employment composition?	Industry	Limited relative growth from early 2000s	Growth from late 1990s	Growth from late 1990s	Limited relative growth from early 2000s	Steady high level (40%) until early 2000s, followed by relative decline until present	Limited data (from 1990 onwards), showing sustained decline
	Manufacturing	Initial decline in mid-1990s, growth from early 2000s and second period of decline from mid-2010s onwards	Growth from late 1990s	Growth from early 2000s	Initial high level until early 2000s, followed by ongoing gradual decline	Continuous growth from mid-1990s	Notable decline from early 1990s
	Services	Steady growth throughout entire period	Rapid growth until 2006, followed by small decline until 2016 and subsequent growth	Plateaued between late 1990s and mid 2000s followed by subsequent ongoing growth	Doubling of services sector employment from 20% to over 40%.	Consistent growth from late 1990s	Sustained growth from early 1990s
Labour productivity		Rapid increase in labour productivity growth rate from 2004	No notable change	No notable change	Sustained continuous labour productivity growth from 1990s onwards	Increase in labour productivity growth rate from 2006	Sustained growth from early 1990s
Have exports diversified?		No notable change	Decrease in diversification from mid-1980s	Increased diversification from late 1980s	Increased diversification from late 1970s onwards	Increased diversification from mid-1980s	Increased diversification from mid-1970s. Slight decline from mid-1990s
Economic Complexity		Increase in complexity since mid-1990s	Constant decline in complexity	Rapid increase in complexity from 1996	No long-term data but second highest complexity score	Increase in complexity from 1998	Significant improvement from the mid-1990s
Product Space 1972-1995		Significant growth in garments and electronics, loss of some vegetable goods	Significant growth of garment sector and some machinery	Significant growth in garments, some growth in fisheries	Significant growth in garments, some limited growth in fish, processed food (sugar) and minerals	Significant growth in garments and fisheries, limited growth in electronics	No data

Product Space 1995-2015	Limited decline in garments, significant growth in machinery, loss of further periphery goods	Limited loss in garments in garments, loss of machinery	Significant loss in garments, significant growth in machinery goods	Decrease in garments, limited increase in fish and agro-processing	No significant changes over period	Significant decline in garments. Increase in chemicals, vehicles, electronics
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