



International Centre for Trade  
and Sustainable Development

*Revisiting Competitiveness Policies  
from a Developing Country Perspective of  
Sustainable Development*

*Werner Corrales-Leal*

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INTRODUCTION..... 3

1. COMPETITIVENESS POLICIES AND SUSTAINABLE DEVELOPMENT IN DEVELOPING COUNTRIES..... 4

1.1 *Sustainable Development Objectives and Competitiveness Policies* ..... 4

1.2 *The most relevant processes in achieving the economic goals of a Competitiveness Policy..* ..... 6

1.3 *The Social Effectiveness of a Competitiveness Policy* ..... 7

1.4 *Mainstreaming Environmental Considerations in Competitiveness Policies* ..... 8

1.5 *Multilateral Trade Rules and the Feasibility of a Competitiveness Policy for Sustainable Development.....* 8

1.6 *Definition and Goals of a Competitiveness Policy for Sustainable Development..* 11

1.7 *Fundamental Actors in Policy Decisions at the National Level.* ..... 12

2. RELEVANT POLICY AREAS IN THE PERSPECTIVE OF COMPETITIVENESS FOR SUSTAINABLE DEVELOPMENT..... 13

2.1 *Policy Categories and Competitiveness-related Policy Areas* ..... 13

2.2 *Macroeconomic policy* ..... 14

2.3 *Competition Policy* ..... 15

2.4 *Trade Policy* ..... 16

2.5 *Technology and Innovation Policy in an integrated course of action with enterprise development, networking and investment policies* ..... 16

2.6 *Socially targeted Competitiveness- related Policies* ..... 18

2.7 *Infrastructure and Logistics Support Policy* ..... 19

2.8 *Environmental Policy* ..... 20

## **INTRODUCTION**

Capacities for competing in international markets can no longer be based on static comparative advantage, nor can tariffs protect inefficient local industries. Furthermore, the traditional factor-based strategies for growth are not efficient responses to the increased international competition that the knowledge revolution has brought about.

International liberalization and deregulation of domestic markets have accelerated the pace at which the innovation-based mode of competition has diffused worldwide. Knowledge intensity of production has gradually extended beyond the high-tech sectors to reshape a broad spectrum of traditional industries. Indeed, where the local knowledge base was deepened and linkages were established to a wider set of knowledge inputs, traditional industries have shown a remarkable vigour in their growth and have joined the innovation-based mode of competition.

These global trends, and the experiences of successful economies in the south, strongly suggest that developing countries would highly benefit from putting in place a knowledge-based strategy for development, i.e., a strategy based on making more effective use of new and existing knowledge and technology throughout the whole economy. In terms of trade and production, such strategy must be expressed as a set of competitiveness policies supported on an innovation system where enterprises, research centres, universities and other organizations interact effectively to create and diffuse technologies using the growing stock of domestic and global knowledge<sup>1</sup>.

Countries that have successfully used trade to promote development have built their competitiveness progressively shifting trade specialisation towards higher value-added goods and services and purposefully creating linkages and dense sets of connections between enterprises. Those linkages are the expression of *Clusters*, complex networks of input-output relations and processes of innovation and knowledge diffusion that allow the economies to sustain export-led growth and translate it into more and better jobs and income gains domestically.

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<sup>1</sup> In addition to an effective innovation system, three factors are cited as key pillars to a knowledge-based strategy: An economic and institutional regime that provides incentives for the efficient use of existing knowledge and the creation of new knowledge and entrepreneurship; an educated and skilled population that can create and use knowledge; and a dynamic information infrastructure that can facilitate the effective communication, dissemination, and processing of information. Dahlman and Aubert (2003).

## 1. *COMPETITIVENESS POLICIES AND SUSTAINABLE DEVELOPMENT IN DEVELOPING COUNTRIES*

Competitiveness expresses itself at the level of firms that participate in competition with other firms. Nevertheless the concept of Competitiveness Policies must address processes that take place at the levels of firms, sectors and national economies, because such policies must serve the purpose of a positive integration of developing countries in the global economy, resulting not only in economic achievements at the level of particular firms, but also contributing to the economic, social and environmental goals of Sustainable Development.

In consequence, taking the perspective of nations competing with others or considering that the commercial progress of certain countries necessarily involve the detriment of others is not essential to an approach to competitiveness policies encompassing sectors and national economies. In other words, the debate over competitiveness of nations or firms does not deserve being replicated here in order to substantiate this approach<sup>2</sup>.

From a policy perspective, a competitiveness policy should aim to promoting changes in the supply as well as the demand side of the economy. In this perspective, the fundamental questions it has to answer are two: How to systematically create opportunities for diversifying production and exports towards goods and services with increased value added and knowledge intensity, and how to introduce mechanisms to translate exports in enhanced welfare gains that, in turn, are spread equitably across society. Actions oriented to address the first question not only involve overcoming supply-side constraints and systematically increasing productivity, but also ensuring effective market access and fair trade to one's exports in foreign markets.

However, there are other dimensions in which competitiveness policies must be judged. In other words, there are other specific conditions that a competitiveness policy must fulfil in the economic, social and environmental dimensions of development to be an effective instrument of development, relevant to developing countries. These policies are trade-related and essentially economic, but they must be framed in a broader strategy for sustainable development, which entails economic, social and environmental goals. On the other hand, there are international considerations, which affect the feasibility of implementing active policies towards competitiveness in present times.

### *1.1 Sustainable Development Objectives and Competitiveness Policies*

Clearly not all problems of development can be solved by competitiveness policies, which are mainly economic in nature, but these policies *may* be instrumental – if so designed – to promoting sustainable human development in its three spheres. Conversely, if they are directed exclusively towards maximising trade or trade-led GDP growth, the outcome might well be that of obstructing the diversification and knowledge intensification of the rest of productive sectors of the country, deterring relevant improvements in productivity,

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<sup>2</sup> The concept of competitiveness and its related “bench markings” branded by the World Economic Forum have improperly led to a pretension that competitiveness implies a capacity and a disposition of a nation to race with others in a “zero-sum” competition. The most known critique to this perspective emanated from Paul Krugman a decade ago (Krugman 1994). However, Krugman’s critique has not been accepted in all its extension by many reputed economists and international organisations (E.g. the OECD and the EU Commission), as it disdains the fact that just improving the capacity of a country’s firms for international competition is not a sufficient condition for making the gains of trade-led growth benefit its whole society.

and most importantly, hindering the possibilities of achieving legitimate social and environmental objectives. Our views are that competitiveness policies in developing countries should be framed within a broader strategy for sustainable development. This entails economic, social and environmental objectives. Box 1.1 offers an illustration of such framework<sup>3</sup>.

**BOX 1.1 AN ILLUSTRATIVE LIST OF GOALS IN A  
TRADE-SUPPORTED STRATEGY FOR SUSTAINABLE DEVELOPMENT.**

The following is a non-exhaustive illustration of development goals that a *Trade-supported Strategy for Sustainable Development* should pursue within the economic, social and environmental spheres of development, defined from a developing country perspective:

**In the economic dimension**, the main development goal should be securing stable, long-term economic growth, based on sustained productivity increases. Four conditions are inherent to this goal:

- Securing stable growth from trade, in the short and long term horizons, including increasing resilience to external shocks;
- Diversifying production and trade towards goods and services of ever increasing value added and knowledge intensity, and favouring knowledge spill-overs from export sectors to the whole economy;
- Reducing productivity and income differentials among regions, sectors and social groups; and
- Increasing the capacity of the economy to translate trade-led growth into more and better jobs and household income.

**In the social dimension**, goals may be summarised as expanding people's freedoms and opportunities and maximising social cohesion. Three objectives may be used to illustrate this goal:

- Substantially contributing to alleviating poverty and reducing inequality and social exclusion, including through creation of stable job sources;
- Ensuring access to basic goods and services for all people, particularly nutrition (food security), health and education, and environmental public goods (e.g. clean air and water); and
- Improving the legitimacy of trade policy, by ensuring its accountability according to social development goals and increasing people's participation in the process of trade policy making.

**In the environmental sphere**, the main objective could be expressed as using natural resources and the environment in a sustainable manner, preserving their value for the benefit of present and future generations. In practice, some environment-related goals that should be pursued within a trade-supported sustainable development strategy are:

- Guaranteeing that economic advantages based on natural resources can be enjoyed and enhanced in a sustainable manner by means of a rational management of natural resource-based industries (E.g. physical and economic policies for conservation of natural resource reservoirs);
- Ensuring that achievements in export growth, productivity and diversification of the economy as well as improvements in consumption, are based on those policy options that most favor environmental sustainability (i.e. environment-supportive trade policy instruments and technologies, infrastructures and productive processes); and
- Actively engaging in trade activities based on bio-diversity goods and services (bio-trade), while conserving biodiversity and eco-systems by introducing economic incentives ensuring their sustainable use.

**Source:** Adapted from Corrales, W. "Ideas for an integrated approach to initiatives related to Competitiveness and Spaces For Development Policies in the road to UNCTAD XI". Geneva (2003).

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<sup>3</sup> Sections 2.2 and 2.3, and Table 2.1 illustrate relations between these objectives and policy goals .

## *1.2 The most relevant processes in achieving the economic goals of a Competitiveness Policy*

Two fundamental sets of economic goals should be addressed by a national competitiveness policy. The first consists of fair competition in international markets, i.e. securing conditions for the realisation of effective market access and fair trade for the country's exports. The second is to help the country in deriving sustained economic growth from that competition, while at the same time achieving a capacity to internally amplify the effects of that export growth in terms of productivity increases, more and better jobs and income improvements for ever-greater proportions of the population.

In a knowledge-based economy, the locus of knowledge creation and the forms through which knowledge is appropriated will increasingly shape opportunities for learning, for innovation and thus for growth and development. For developing countries the result of this process may be a virtuous spiral of development or a vicious cycle of cumulative inequalities with respect to developed countries, depending on the access to knowledge they effectively achieve. It is in this context that accepting a role of developing countries and economies in transition as 'technology users', or implementing technology policies that depend only on technology transfer results short sighted.

The goals related to market access and fair trade conditions fall within the sphere of "trade policies". In this realm, active export promotion, as well as negotiating tariff reductions and the removal of non-tariff barriers, and ensuring that disciplines on subsidies and related matters are complied with, are important movements. But achieving effective entrance to real trade channels –many of them under control of oligopolistic networks<sup>4</sup>- and developing innovative ways for defending exports prices are as important and not very often are related to initiatives for competitiveness improvements or actively mainstreamed by developing countries in their trade negotiating positions.

Referring to the enhancement of supply-side capabilities and internal amplification of benefits, the goals of a competitiveness policy can be expressed in terms of realising competitive advantages in a manner that it contributes to reducing differences of productivities among sectors and regions, which in turn results in improving personal income distribution among social groups.

Two policy considerations must be made to this respect:

- Competitive advantages that may be exploited today by developing countries - in order to diversify their exports towards higher value added goods and services - are mainly based on flexibility and innovation instead of scales and prices. In many ways, the smaller group of successful economies previously mentioned were able to catch up by basing their economic growth on a constant learning process<sup>5</sup> which in turn was supported by a sustained investment in human capital at one end, and by an actively pursued course of technology development and innovation at the other.
- The value associated to policies oriented to promoting complementarities between economic activities and linkages between firms (enterprise networks, industrial

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<sup>4</sup> Global Value Chains, controlled by multinational corporations, including shipping cartels in which transport prices suffer "escalation" according to their level of processing.

<sup>5</sup> Stiglitz (1999) notes "[...] the accumulation of capital could explain only a fraction of the increases in per capita income in the countries in East Asia Their miraculous growth is largely attributed to closing the knowledge gap, the gap between the more developed and less developed countries..."

districts and clusters of SMEs and big corporations including multinationals) go far beyond the obvious input-output relations because innovation processes are supported by the flow of information resulting from interaction between enterprises, associated to these networks.

Deepening complementarities and linkages, promoting supply chains, clusters and industrial districts may be at the same time valuable instruments for fostering learning, technology development and diffusion processes, and effective mechanisms for multiplying the effects of export growth in favour of employment and income distribution.

For developing countries the ideas presented above mean that their capacities for catching up and keeping up have become a direct function of their ability to incorporate their export supply under fair trade conditions in the Global Value Chains, and their capacities for continuously sustaining learning processes, innovation and technological upgrading, including technology transfer.

The competence of developing countries for integrating their populations to benefiting from growth is in turn direct function of their skills for reducing productivity gaps and deepening the complementarities and linkages between sectors and economic units.

Therefore active competitiveness policies based in the above mentioned factors must be pursued at country level and spaces for their implementation must be secured in the international negotiations.

### *1.3 The Social Effectiveness of a Competitiveness Policy*

Competitiveness policies must be socially effective, i.e., they must effectively contribute to the enhancement of opportunities and freedoms, including the generation of sustained and relevant real income increases for the majority of the population.

But social effectiveness of economic policies (in this case of competitiveness policies) must refer not only to bridging inequalities but also to reinforcing social cohesion, social integration and collective resources of society. Achieving a positive integration in the global economy and realising social efficiency in societal terms ( being capable of pursuing human development) calls for implementing active policies in which it is not only necessary to make use of competitive advantages; it is also required to develop specific forms of policy governance, cooperation and mutual trust among actors.

Obviously a competitiveness policy package can not on its own secure the full attainment of these objectives, but it may positively contribute towards them through the effects of two complementary lines of action. The first consists of the creation of more and better jobs and wages in the whole economy, resulting from the implementation of the “core components” of the competitiveness package (i.e. diversification, linkages creation and innovation). The second implies inducing direct positive impacts in the urban informal sectors and the rural low-productivity sectors by means of promoting concrete synergies between them and the economy-wide reforms.

Examples of these synergies are introducing institutional innovations allowing these sectors to directly benefit from facilities in the financial markets; and fostering/strengthening networks of cooperation on which they may support their economic operation while at the same time contributing to maintaining the solidarity associations that enhance their social impact on poor communities (e.g. cooperative networks and other forms of social capital).

These connections between economic policies and social goals are very important for the sustainability of development in many developing countries, where social exclusion and political polarisation are rooted in the incapacity of the “modern economy” to provide jobs and sources of income to a substantial part of the population. The “social effectiveness” of a competitiveness policy must pass this test.

#### ***1.4 Mainstreaming Environmental Considerations in Competitiveness Policies***

There are also indirect positive environmental impacts which may derive from the attainment of specific goals of a competitiveness policy in the economic dimension. For instance, diversifying production and trade towards higher value-added products (goods and services, including environment and energy-related services), while enhancing internal multipliers and reducing heterogeneity in productivities at the same time, may help achieving higher rates of growth and better social results with a lower intensity of resource exploitation. Achieving enhanced and non discriminatory access to developed countries’ markets for resource-based or environmental sensible export products is another example of an indirect connection between economic and environmental goals.

Therefore, at least two cross-cutting environmental considerations must be incorporated into the competitiveness policy mainstream in developing countries, in order to contribute to environmental sustainability, but also to secure related achievements in economic benefit from their integration into the global economy. In the first hand, it must be realised that the present trends shown by trade in the majority of developing countries, based in a simultaneous increase in exports of commodities supported in natural resources, and the reduction of their relative international prices, lead not only to poverty but also to increased rates of exhaustion of their resources. In the second hand, the existence of environmental consciousness in many export markets and demands for compliance with environmentally friendly practices are key, forcing developing countries to relate to these criteria in order to compete in those markets. In consequence, the enhancement of productive processes through competitiveness policies must effectively help developing countries to revert the trends described and to avoid depleting the natural resource base, a negative environmental experience that some of the successful developing countries mentioned lived through in the recent past.

But there are other more specific objectives related to environmental impacts and environmental sustainability that any trade-supported productive development policy or competitiveness policy should pursue: The first consists of conserving biodiversity and eco-systems while actively benefiting from trade on goods and services based on bio diversity (bio-trade); the second is ensuring that economic assets and continuity of production and trade are not hampered as a result of environmental vulnerability to natural disasters, a situation which has become more frequent for developing countries over the years.

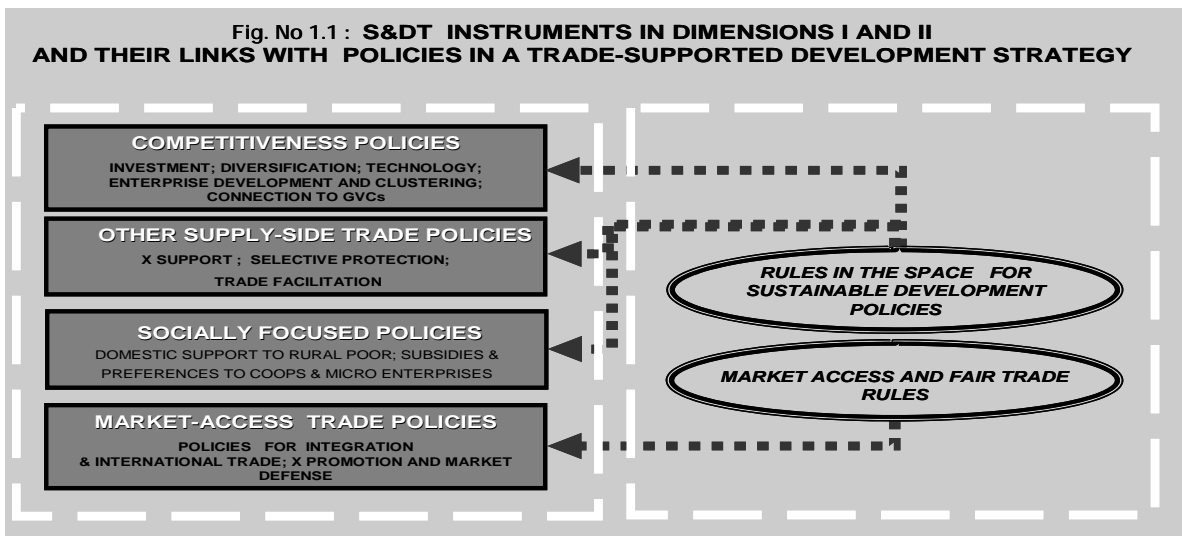
#### ***1.5 Multilateral Trade Rules and the Feasibility of a Competitiveness Policy for Sustainable Development***

Finally, the feasibility of a competitiveness policy stems not only from internal institutional factors within the countries, but also from constraints originating mainly from two sources. The first is insufficient availability of resources for investment. The second is the multilateral framework of trade rules.

Necessary complements of an active policy for competitiveness are of course the resources for investing in infrastructure, logistics and institutional adjustment, on one hand, and the flexibilities to implement active policies in the supply side, on the other. Ensuring both conditions entails maintaining a pro-active stance in international negotiations, both in trade talks in WTO and the FTAs, and with the IFIs.

The development challenges and problems that developing countries face in their incorporation into the world economy, may be classified according to three broad dimensions in which policy instruments and trade rules affect these problems.

The first two refer to policies aimed at achieving effective access to trade opportunities and to improving systemic competitiveness as well as social and environmental conditions (see Figure No. 1.1).



The third dimension refers to net resource inflows that developing countries may need to relieve major supply-side constraints<sup>6</sup>, undertake institutional reform and implement institutional capacity building.

In the Market Access and Fair Trade dimension, developing countries seek improved entry to foreign markets through traditional mechanisms (e.g. preferential tariff treatment, rules of origin, etc.), as well as solutions to the negative impacts that third countries' trade policies may have on limiting their exports (e.g. anti-dumping and countervailing measures, misuse of technical or sanitary standards or export subsidies, etc.).

The most important limitations on developing countries in realising effective access to trade opportunities will only be overcome if they are tackled by means of new responses

<sup>6</sup> Supply-side constraints in this context include low labour productivity and structural limitations in the institutions to overcome such restrictions (e.g. poor educational and health service systems); limited mastering of management know-how, lack of appropriate process technology and weakness in the national innovation systems; scarcity of input-output linkages between exporting sectors and domestic productive units, mainly SMEs, implying insufficient upstream impacts of job creation and knowledge spillovers; low quality and limited coverage of infrastructural supports resulting in poor connectivity to global markets (poor transportation and access to shipping infrastructure, telecommunications), and inappropriate macroeconomic policy frameworks leading to unstable exchange rates and high inflation. ICTSD and APRODEV (2005).

through the Multilateral Trading System (MTS)<sup>7</sup>; they can not be solved by only improving developing countries' domestic policies. Effective access of all developing countries to trade opportunities would ensure the contribution of trade to financing the costs of development initiatives in general, and particularly to supporting the costs of adjustments that are required for their integration into the MTS. For developing countries the result of this process may be a virtuous spiral in which they become increasingly capable of growing and integrating in the trade system, or a vicious cycle of cumulative failures.

In the Space for Sustainable Development Policies (Policy Space) dimension, developing countries implement actions for improving competitiveness, including through knowledge-based strategies (e.g. fostering diversification, complementarities and linkages, enterprise networks and innovative clusters; supporting R&D activities), and target trade-supported policies in environmental or social goals (e.g. poverty alleviation, support to poor farmers), both of which may be affected by trade rules.

Implementing active policies for productive sector development and competitiveness in developing countries might deserve support from the international trade regimes. However, it must be noted that using the 'policy space' approach does not imply a completely open-ended flexibility or 'policy space' in S&DT, as a balance must clearly be struck between the flexibilities required and the need to maintain the inherent value of a rules-based trading system. Discussions about 'policy space' in the MTS have ranged from groups demanding open-ended policy spaces for developing countries in any circumstances – at one extreme – to experts in the mainstream trying to discredit any 'policy space' proposal, even under transparent rules and for addressing specific development situations related to competitiveness, equity and social goals<sup>8</sup>, at the other.

In parallel with this discussion, ideas have been raised about “two-track” solutions to the issue of flexibilities and policy spaces. One case is the proposal for a “fast-track process” for the accession of poor countries to WTO, associated to automatic S&DT; other examples are the ideas that have been advanced on ‘opt-out’ solutions<sup>9</sup> and plurilateral agreements for new disciplines that many developing countries have rejected on grounds of policy space losses (e.g. investment and competition).

Lastly, mechanisms in the third dimension (Resources for Development Support) encompass those ensuring effective access for developing countries to net resource inflows (transfers) that may contribute to financing the costs of institutional adjustments and enhancement of capacities, including overcoming the most pressing supply-side constraints. A main component of the third dimension is technical assistance for reforms and capacity building, some of which must take place in order to enable actions in the other two dimensions.

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<sup>7</sup> In relation to new responses that the MTS should give, issues to be explored would include trade preferences; commodities trade and the unbalanced appropriation of rents along Global Value Chains.

<sup>8</sup> Examples of policy practices involving the need for policy spaces are those related to: knowledge-based strategies such as fostering diversification, enterprise networks and innovative clusters and supporting R&D activities; supply-side trade strategies (e.g. selective import liberalization, trade facilitation reforms), and trade-supported strategies targeted in environmental or social goals, for example supporting productivity improvements of poor farmers and granting government procurement preferences to networks of cooperatives and micro-enterprises.

<sup>9</sup> For a broad discussion of cases see Charlton (2005) and Hoekman (2004)

## 1.6 Definition and Goals of a Competitiveness Policy for Sustainable Development

A very important conclusion may be drawn from the above-presented comments. Policies for competitiveness aimed at social, economic and environmental goals must be implemented in order to promote an integration of developing countries in the global economy, effectively supportive of development.

It must be a Competitiveness Policy for Sustainable Development, defined as one conducive to

...“Strengthening and enhancing the production structures, trade capacity and policy institutions of a country, with a view to improving its ability for a positive integration in the global system securing long term, stable economic growth, based in producing goods and services that meet the test of international competition under fair market conditions, while expanding the real incomes and real freedoms of their citizens and using their natural resources and the environment in a sustainable manner, preserving their values for the benefit of present and future generations”<sup>10</sup> ...

In operational terms, based on the arguments and definitions presented above, competitiveness policies in developing countries can not be limited to the enterprise level and/or to creating the appropriate macroeconomic environment. Nor can they depend on just promoting FDI, expecting that foreign investment will automatically facilitate improved revenues from effective market access, foster diversification or produce effective technological spill-overs. Policy actions towards competitiveness must also be directly aimed at:

- Improving the ability of firms and productive chains to innovate and incorporate technology in a way that facilitates changes in the country’s trade specialisation towards value-added and knowledge-intense goods and services. This, in addition to gaining effective market access and competing in their traditional exports, is essential to sustain productivity growth;
- Supporting learning processes in the economy by means of improving quality and efficiency of education systems at primary, secondary and tertiary levels;
- Sustaining efforts aimed at building strong and dense fabrics of firms, mainly SMEs, and creating conditions for linkages between domestic producers and Global Value Chains connecting the former to international trade, in order to enhance on a sustainable basis the capacity for creating better jobs and amplifying the positive impacts of trade into the internal economy;
- Contributing to the social effectiveness of economic policy in general, by means of positive actions in favour of urban informal sectors and low-productivity rural production;
- Mainstreaming environmental goals and criteria as crosscutting issues in all policies (horizontal and selective), to ensure sustainability in terms of the intervention of natural resources, and to enhance the opportunities for developing countries to

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<sup>10</sup> This definition resulted from a joint exercise by the UNCTAD-UNDP Global Programme and ICTSD, drawing from Chudnovsky (2003), Chesnais (1995), Esser (1999) and OECD (1992, 2000).

successfully compete in world markets that increasingly demand environmental performance; and

- Coordinating trade and productive sector development policies in the whole economy, and strengthening the capacities of institutions in charge of their execution, by improving their capabilities for policy design and implementation, as well as for related trade rules negotiations at the international level.

### ***1.7 Fundamental Actors in Policy Decisions at the National Level.***

In many developing countries new trends are emerging, decentralizing public decisions historically made at the central levels to the spheres of influence of local government. In addition to this, civil society organizations, institutions of the business sector and big corporations, among other actors, increasingly influence decisions on public policy and permanently demand participation in them.

The new patterns of decision-making in economic policy areas consist in negotiations among many actors along “policy networks”, substituting the old hierarchical patterns in which states made decisions mainly at the central levels, in some cases consulting the business communities in the process. On the other hand civil society around the world demands more transparent and participatory processes in relation to the problems and challenges faced by communities in all dimensions of development. This kind of interaction between relevant actors increasingly determines the way globalisation shapes itself in developing and developed countries, at the national and international levels.

Public policy in general, and decision-making on policies affecting competitiveness in developing countries, in particular, are no longer the exclusive acts of governments; other actors increasingly share the responsibilities and even lead the process. International institutions and civil society organizations interested in trade and development<sup>11</sup> should consider these facts and start interacting more systematically, on the basis of predefined agendas, with the most relevant actors of these policy networks.

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<sup>11</sup> E.g., UNCTAD, Oxfam, the ICTSD, the South Centre, among others.

## 2. RELEVANT POLICY AREAS IN THE PERSPECTIVE OF COMPETITIVENESS FOR SUSTAINABLE DEVELOPMENT.

Policies for competitiveness may be considered “horizontal” or “selective” depending on the focus or the exclusiveness of their application. Selective policies may target economic, social and environmental objectives and are focused on specific regions (sub-national spaces) or particular economic activities, in this case selected according to sectoral or market destination criteria (production oriented to domestic or foreign markets)<sup>12</sup>. Horizontal policies may also target economic, social and environmental objectives, but they are applied without focusing on specific regions or economic activities.

### 2.1 Policy Categories and Competitiveness-related Policy Areas

In any policy area, policy actions may be regulatory in nature (regulations establishing the ‘rules of the game’, and supervision of their compliance), or may be active interventions. The latter may take the form of ‘signals’ that stimulate certain market reactions, or consist of the state directly taking on the role of economic agents (i.e. investor, entrepreneur, or consumer).

It is important to notice that not all policies are active in nature; neither all-active policies attempt to substitute market mechanisms. Even the act of establishing a new regulation for the pursuit of enhancing competition consists of an active intervention from the state in the marketplace.

Some regulatory policies have the character of enabling frameworks, in the sense that they create the necessary conditions for other policies to be feasible, either active or regulatory.

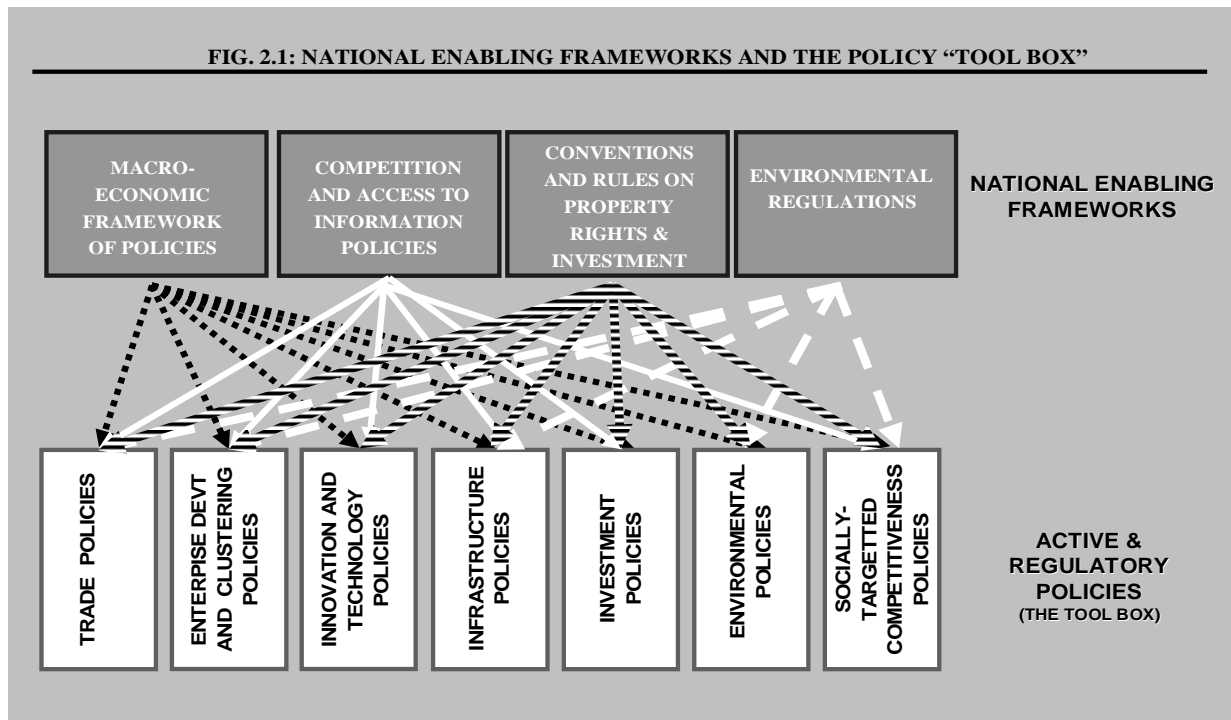
There are also higher levels of institutions, rules, conventions and basic societal consensus supporting visions and enabling the existence of policies. For instance, values, conventions and rules in this level, commonly referred to as the “meta-level” of policies (Meyer-Stamer 1998), generate certainty and governance conditions enabling actors to make ‘calculated risk’ decisions. In other words, they contribute to maintaining the perception of risks and uncertainty within limits that actors consider ‘acceptable’ to act, moving processes in a sustained manner.

Eleven policy areas deserve explicit attention when referring to competitiveness. Regulations in four of them represent what we refer to as national enabling frameworks that facilitate the successful implementation of other relevant policies.

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<sup>12</sup> In the WTO, World Bank and IMF policy environment, selective policies, in particular those active policies focused on specific economic activities are considered in general negative, because their ‘distortive effect on market mechanisms’. For instance, only specific subsidies are subject to the WTO Agreement on Subsidies and Countervailing Measures, and only subsidies conditional to export performance or local procurement of goods are prohibited under its provisions.

FIG. 2.1: NATIONAL ENABLING FRAMEWORKS AND THE POLICY “TOOL BOX”



The policy areas of trade; innovation and technology; investment; enterprise development and clustering; as well as infrastructure, constitute the “tool box” for policy interventions aimed at economic goals related to improving competitiveness and the development of productive capacities. A competitiveness area focused on social goals has been singled out in that “tool box” to highlight the fact that informal sectors in the cities and low-productivity rural sectors deserve specific policy attention.

We note that the practice of ‘regional development policy’<sup>13</sup> has been taken into consideration in the nine policy areas above, as well as in the economic objectives of sustainable development outlined earlier.

The environmental component deserves a special comment. As may be evident in the graphical representation above, environmental regulations embody frameworks for the implementation of policies in other areas affecting competitiveness or productive capacities development; yet on the other hand, certain environmental policy instruments are clearly part of the “tool box”, i.e., they may be actively used in directly supporting the attainment of policy goals related to diversification or competitiveness.

## 2.2 Macroeconomic policy

Good macroeconomic conditions enable other national policies including in the areas of enterprise development, technology, infrastructure and environment to become successful. Financial and monetary crises and inflation, sudden exchange rate devaluation, sharp instabilities in export prices contribute to reversals of competitiveness achievements. An enabling macroeconomic framework should contain actions to ensure prudent macroeconomic management, including fiscal discipline and policy-oriented budgetary

<sup>13</sup> Current approaches in regional development policy aim at mobilizing endogenous potentials by actively developing competitive advantages, thus they are difficult to distinguish from policies to strengthen industrial locations (Meyer-Stamer 1998).

(public investment) goals; balance of payments and capital flows mechanisms conducive to limiting vulnerability to external shocks.

But it is equally important that a macroeconomic framework provides for measures facilitating competitiveness policy goals including incentives for fostering R&D activities, financial instruments supporting programmes in enterprise development, technology acquisition and environmental up-grading, as well as sustained support to socially targeted programs related to the informal sectors.

Incentives and regulations aimed at the financial sector may have a considerable impact on real access of firms (especially SMEs) to financial means for acquiring technology or carrying out innovation and industrial restructuring processes. In this respect corresponds to this policy area introducing competition into the banking sector and establishing regulatory schemes allowing for financing in “soft terms” SMEs engaged in clustering and technological up-grading.

### 2.3 Competition Policy

Competition policy may be a major support for productive development as competition ensures efficiency in the allocation of resources and forces firms to improve performance for the benefit of consumers, users of intermediate products, and the economy as a whole. As an enabling framework for competitiveness, competition should contribute to effectively encourage technology upgrade and innovation among competing firms and to support the efforts of enterprise development, clustering and investment policies.

With these objectives in mind, two specific concerns related to competitiveness must be taken in consideration when conceiving and implementing a competition policy:

- Competition policies must allow for policy flexibilities needed for productive capacity development at the country level. They must enable developing countries to successfully promote clusters and other “cooperative competition” arrangements among firms, especially SMEs, oriented to ensure increased synergy effects, and have a realistic approach to the issues of mergers. The appropriate considerations should allow for coping with international competition and promoting alliances between TNCs and domestic firms, while supporting the policy goals related to development of domestic capital and discouraging acquisitions of local firms by foreign entities when they may create or aggravate monopoly situations or abuse of dominant power.
- Intellectual Property Rights (IPRs) regimes must be implemented ensuring that technology upgrading; adaptation and in general legitimate access to knowledge by national actors are not obstructed. Knowledge is at the centre of competitiveness policies and access to knowledge may be hindered by the action of “knowledge based oligopolistic networks” at the global level<sup>14</sup>.

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<sup>14</sup> Although a lack of IPRs may discourage investments in R & D and reduce innovation at the global level, which is one of the main expected benefits deriving from competition, abuses may seriously hinder the attainment of development objectives of developing countries in a *Trade-supported Development Strategy*. An example is restraints imposed through the licensing procedure of an IPR. Trade marks can be used to seal off and monopolize specific markets. Another is obstructing access to knowledge by limiting legitimate R&D initiatives.

## **2.4 Trade Policy**

In the framework of a strategy for competitiveness, all trade policies to be implemented at the national level are relevant for a developing country. In addition to this, as it has been said in previous sections, a proactive stance of developing countries in international negotiation of trade rules may make the difference between having an enabling international framework for competitiveness policies or not.

A strategic conception and implementation of trade policies implies differentiating and combining two categories of policies according to the country's interests and opportunities. They are, on one hand policies oriented to secure effective market access and fair trade conditions for the country's exports, and on the other policies targeted in supporting the supply-side:

- Positive actions must be undertaken to facilitate real access of domestic production to trading channels (incorporating to Global Value Chains and servicing from shipping providers, very often oligopolistic consortiums in practice), in conditions allowing for a better remuneration. This entails a combination of national policy measures in export promotion; trade facilitation for reducing transaction costs; technical assistance to SMEs aimed at improving quality and technical standards; incentives and financial support for promoting cooperation between TNCs and domestic suppliers. But it also implies international policy measures in the realm of competition that can only be achieved in international negotiations, especially at the multilateral level.
- Supporting the supply side may entail strategically managing imports trade liberalisation, either on selective or gradual bases or not; granting support to exporting capabilities of firms; and providing selective trade protection of specific sectors if needed<sup>15</sup>. In this dimension it is necessary to create a clear regulatory framework and a fairly good institutional capability for benchmarking and following up progress in competitiveness of firms, in order to ensure that these measures achieve their goals and do not become permanent protections of non-entrepreneurial actors.

## **2.5 Technology and Innovation Policy in an integrated course of action with enterprise development, networking and investment policies**

New types of policies are required and conventional views on learning and technology upgrading in developing countries should be rethought to meet the new challenges created by the knowledge-based mode of competition. Concepts that embody dynamic change, such as the notion of an 'innovation system' should be introduced into policymaking in order to benefit from the fact that innovation not only takes place in laboratories of large corporations or in the high tech industries; nor is it reduced to inventions or to the kind of activity that takes place at the technological frontier.

In the realm of the economy, innovation must be understood to be...

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<sup>15</sup> Since the 1980s, under the title "strategic trade policy", some economists criticise neoclassical orthodoxy according to which free trade has a welfare-maximizing effect in any case, and they argue that, given selective protection of its industries, a country may gain advantages which cannot be obtained under free trade. Meyer Stamer ( 1998)

“...the process by which firms develop, master and implement the design and production of goods and services that are new to them, irrespective of whether or not they are new to their competitors —domestic or foreign...”<sup>16</sup>

This definition acknowledges a role for developing countries as producers and not only as users of technology. By adopting it, identifying opportunities for learning and innovation in small and medium-sized enterprises (SMEs) or in traditional sectors will be easier than has been the case in the past. By re-conceptualizing industries and sectors within them as ‘innovation systems’, the focus can be clearly placed on the configuration of critical actors in such a system, their habits and practices with respect to innovation, their level of competence and the nature of their interactions. Weaknesses and strengths in the system emerge more clearly in such a perspective and can more easily be targeted through policy.

Assuming a new policy approach based in the innovation system perspective and the broader definition of innovation previously discussed have direct relevance for stimulating and supporting a continuous process of learning and innovation in developing countries.

While recognising the importance of absorbing and mastering imported technology (technology transfer) in order to transform it in new ways, this policy approach also values and fosters two processes of the highest importance in developing country economies. The first is building upon indigenous knowledge and exercising creativity in the development of new products and processes, management routines or organizational structures that correspond to local conditions and needs; the second is creating and strengthening the local linkages that support the modification of production processes to bring costs down, increase efficiency and ensure environmental sustainability.

Enterprise development policies, as well as clustering and networking policies (promotion of inter sectoral complementarities and linkages), together with technology transfer and innovation policies constitute the core of the supply-side measures aimed at developing competitiveness and promoting diversification towards production of higher value-added goods and services in all sectors.

These policies have to be conceived in an integrated course of action, combining the microeconomic approaches of managerial and technical improvements at the enterprise level with the promotion of positive externalities by means of linkages creation, networking and cooperation, and fostering sustained learning and innovation processes in the whole economic system. All sectors of industry and agriculture must be the subject of these policies, in which knowledge-intensive service sectors<sup>17</sup> should be used as a lever.

In their immediate relation to firms’ and sectors’ competitiveness and diversification, the purposes of these policies may be very diverse, but they may be summarised as focusing in three goals:

- Supporting managerial and technological upgrade of enterprises, particularly SMEs, including facilitating the provision of inputs and services and ensuring bank credit for financing technological upgrading and restructuring processes in firms, at favourable interest rates. Depending on the level of complexity and the development stage of specific manufacturing and service industries in the country

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<sup>16</sup> Mytelka, Lynn “Use vs. Produce in the ‘Adoption of New Technologies’: Revisiting the debate from a learning and innovation perspective”, *UNU/INTECH*, Maastricht 2002.

<sup>17</sup> E.g., software and other IT-related service companies; energy services providers; firms in the environmental fields of prevention and remediation; technology consultancy and R&D institutions; engineering design and construction management; or multi-modal and clustered transportation services...

and its sectors or regions, policy decisions might consider giving a higher or lower priority to supporting design and R&D capabilities, and technical extension services for SMEs<sup>18</sup>.

- Contributing to the consolidation of clusters, networks and industrial districts integrated by SMEs and major firms, and promoting linkages cooperation schemes between SMEs and transnational corporations as well as major national enterprises participating in sizable markets<sup>19</sup>.
- Promoting investment either focused and selective regarding economic sectors<sup>20</sup>, or generalised and “horizontal”. Attracting export-oriented FDI and international enterprises willing to participate in programs comprising supply chain development and technology transfer with SMEs is an instrument for increasing the production of manufactures and services for export, as well as for technology upgrading of existing enterprises and industrial segments.

Policies on technology, innovation and knowledge are broader in scope, but in their relation to competitiveness they are responsible for sustaining a permanent course of productivity improvement and product diversification. Therefore, they must be aimed at fostering learning processes in the economy and promoting the generation and diffusion of know-how, which describes the functioning of national and local innovation systems. Part of this task is supporting the production and adaptation of technology, a fraction of which is promoting and facilitating technology transfer.

Finally, technology and innovation policies should contribute to incentivate development and adaptation of technologies that help the most poor, implementing incentives for research in areas where basic needs can be covered. The need for proper housing, built with materials and technologies adequate to the conditions of a region, could foster research in local universities. Groups of local building firms, including cooperative-like association of SMEs could benefit from this research and based on effective local demand, contribute to improving the living conditions of the population.

## ***2.6 Socially targeted Competitiveness- related Policies***

Policies contributing to competitiveness focused in social goals -in the informal sectors and low-productivity rural production- may be aimed at three goals:

- Ensuring that the two mentioned sectors are positively impacted by economic growth which may derive from national macroeconomic and trade policies. For instance, by promoting the dynamism of effective demand in a manner that the informal sector can benefit from, by means of national policies that entail commissioning local (community) services to cooperatives and granting preferences to micro-enterprises and cooperatives in certain areas of government or public enterprise procurement;

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<sup>18</sup> Within this goal an example is providing part-grants for SMEs to obtain ISO9000 certification, establishing productivity centres to improve productivity to world standards, and an awareness campaign for industry about technology gaps and available services .Wignaraja (2000)

<sup>19</sup> This refers to economies of scale that are necessary to cope with international competition, and to promoting joint ventures and other alliances for fostering innovation and technological upgrading in general, including, but not limited to technology transfer.

<sup>20</sup> A commonly found problem in investment promotion policies is the lack of focus and a limited targeting of individual firms and investor markets, which must be addressed targeting realistic opportunities in particular sectors or in specific aims established in the development strategy.

- Introducing institutional innovations allowing these two sectors to directly benefit from the dynamics of domestic market reforms (E. g. by i) promoting institutional and legal reforms enabling the recognition of the conventions and specific forms of property, associations and contracts existing in the informal sector by the institutions and the rest of the economy, and ii) its connection to the mechanisms of social security and financial markets, among others), and
- Fostering and strengthening networks of cooperation (cooperatives and similar) on which they may support their economic operation while at the same time contributing to maintaining the solidarity networks that enhance their social impact on poor communities.

Within the last line of work it is worth mentioning assisting micro enterprises and cooperatives in the cities and rural areas in upgrading and networking initiatives, including in improving their access to soft (subsidised) financing.

## *2.7 Infrastructure and Logistics Support Policy*

An efficient infrastructure and logistics system is needed by developing countries for reducing transaction costs for its enterprises relative to those of their competitors in other economies. This encompass providing supports and services to all sectors in trade facilitation, transportation, storage and logistics information systems; water, energy and telecommunication facilities (e.g., ports air and sea cargo, airport facilities, roads and gas and electricity supply), as well as dedicated and selective infrastructure support given to particular initiatives involving clusters, industrial districts and R&D facilities.

Competitiveness and the development of productive capacities in developing countries may be supported by infrastructure and logistics support policies by means of contributions of three kinds:

- Providing efficient infrastructural support and information connectivity in the already mentioned fields;
- Putting in place a competition-oriented regulatory framework allowing for different options for efficiently financing and managing large infrastructures and logistics systems. Examples of these options are ensuring entry to low cost foreign operators; commercialising infrastructure parastatal enterprises; and promoting private-public joint ventures and other arrangements combining some private sector funding and private sector management with government funding and financial guarantees (e.g., Build-Operate-Transfer (BOT) and Design-Build-Finance-Operate (DBFO) schemes); and
- Making use of public procurement (government and public-owned enterprises) involved in these infrastructure fields, to support the development of domestic private capacities in the provision of high value-added services (e.g., engineering and construction services; trade facilitating and logistic services associated to ports, airports and modal-exchange systems).

## *2.8 Environmental Policy*

It is necessary to say that the connection between competitiveness policies, on one hand, and environmental goals and policy on the other, must be always regarded as a two-way relationship. Competitiveness policies must contribute to the environmental goals of sustainable development and environmental policy must provide instruments that enhance the firms' capabilities to compete internationally, as well as safeguard productive capabilities and competitiveness achievements from environmental risks. Losses caused by natural disasters very frequently damage productive capacities and hamper competitiveness gains for long periods, and their recovery implies costs which are unbearable for the majority of developing countries.

Four means are suggested here for making environmental policy and other competitiveness-oriented policies synergic:

- Innovating in methods for implementing environmental policy itself, in order to improve its effectiveness at the enterprise and industry levels, making use of economic instruments. Economic instruments as pollution certificates are more efficient, because emissions will then be reduced where costs are lowest in relative terms. Instruments like environmental management and eco-audits make the simultaneous achievement of economic and ecological advantages possible at firms' level. (Meyer-Stamer,1998);
- Facilitating an enabling framework for promoting trade in goods and services based in bio-diversity, a competitive advantage that must be exploited by developing countries, while ensuring the sustainability of the practices involved;
- Introducing environmental concerns and objectives as cross-cutting issues in all other competitiveness related policies; e.g., giving financial support to R&D activities focused in developing environmental-friendly processes, or supporting the development of enterprises in the fields of environmental services and bio-trade activities, and
- Incorporating natural disaster (risk) prevention in all spheres of public planning. Four lines of work should cope with this issue by means of reducing vulnerability to risks and improving the capacities of the productive sectors for recovery: i) introducing best practices in land use, territorial planning and major infrastructure design and building standards; ii) establishing sectoral management criteria in services (e.g., water and energy) for improving the resistance to long periods of climatic disturbance; c) introducing regulatory provisions in the insurance industry, in order to provide for extraordinary financial sources for reconstruction and recovery; and d) supporting research and specialised training activities related to the previously mentioned lines of work.

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