

# Are Export Product Diversification and Trade Policy Liberalization Complementary or Substitutable in Promoting Inclusive Growth in Developing Countries?

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## Abstract:

This article investigates empirically the interplay between export product diversification and trade policy liberalization in promoting the inclusiveness of economic growth in developing countries. The empirical analysis relies on a sample of 109 countries over the period 1995-2015 and shows that countries with a high level of export product concentration tend to adopt trade restrictive measures so as to achieve inclusive growth. However, for higher degrees of trade policy liberalization, export product diversification and trade policy liberalization are highly complementary in promoting inclusive growth. One policy implication of this analysis is that to promote inclusive growth, countries that intend to diversify their export product basket should both implement policies in favour of export diversification and further liberalize their trade regimes.

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## 1. INTRODUCTION

Inclusivity (or inclusiveness) has featured prominently on the sustainable development goals (SDGs) also referred to as Agenda 2030. There is a debate in both the academic and policymakers circles on the factors, policies and strategies governing the inclusivity of economic growth (Aoyagi et al., 2016; Doan and Wan, 2017; Kireyev and Chen, 2017; Samans et al., 2017). Likewise, a strand of the literature has particularly investigated the relationship between trade policies (or international trade in general) and inclusive growth (Lederman, 2013; UNESCAP, 2009 and 2013; UNECLAC, 2014; Winters, 2014; OECD/WTO, 2015; APEC, 2015; OECD/World Bank, 2015; World Bank and WTO, 2015; WTO, 2016a and 2016b; IMF, 2017; Kang et al., 2017). The concept of "inclusive growth" has been defined in various ways in the literature, and there is currently no agreement among

economists on a unique definition of this concept (Ranieri and Ramos, 2013). While some researchers have confined inclusive growth to the reduction of absolute poverty, others have considered the inclusivity of growth as the distribution of economic growth payoffs. For example, according to Beegle et al. (2014), growth is inclusive if people or households in the lower income brackets are benefitting equally or more than the total population. Klasen (2010) has considered growth as inclusive if it mainly benefits the disadvantaged groups by reducing disparities across gender and ethnic groups. Other studies (Son and Kakwani, 2008; Anand et al, 2013; APEC, 2015; Aoyagi and Ganelli, 2015) have defined inclusive growth in terms of both the pace and distribution of economic growth.

Interestingly, an emerging literature has made reference to the concept of "inclusive trade policies/inclusive trade" (UNESCAP, 2009; UNESCAP, 2013; UNECLAC, 2014; OECD/World Bank, 2015) and even "trade for inclusive development" (UNCTAD, 2007; OECD, 2010; WTO, 2011; the World Bank, 2011). For example, UNESCAP (2009) has defined inclusive trade policy in terms of "pro-poor trade

1 See the Agenda 2030 online at: <https://sustainabledevelopment.un.org/post2015/transformingourworld>  
2 A survey on the matter could be found in Kang et al. (2017).

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policy", that is, by aligning the objectives of such a policy both with poverty reduction, and the provision of fairer and more equitable access to benefits of economic openness. UNESCAP (2013) has proposed that inclusive trade (and investment) imply that all people can participate in, and benefit from those activities. It considers that trade and investment will only be inclusive if it is fully consistent with the principles of inclusive growth, which implies that all people can contribute to and benefit from international transactions. UNCTAD (2007) has defined 'trade for inclusive development' as a process of globalization that benefits countries and population segments that were previously excluded. According to the WTO (2011), trade for inclusive development refers to the trade that improves access to jobs, wages and stability. The World Bank (2011) has considered 'trade for inclusive development' as a type of trade that entails the facilitation of workers and enterprises' movement to growing sectors, and the adoption of new technologies with a view to enhancing productivity growth and employment in a broad group of workers and enterprises.

Among the studies that have explored the macroeconomic determinants of inclusive growth (Anand et al. 2013; Aoyagi and Ganelli, 2015; APEC, 2015; Aoyagi et al. 2016 and Kang et al., 2017), the ones that have particularly looked at the role of trade on inclusive growth (APEC, 2015; Kang et al., 2017) have paid less attention to the empirical effect of export product diversification on inclusive growth. This issue is all the more relevant because scholars and researchers (Strobl, 2005; Herzer and Nowak-Lehmann, 2006; Naudé, Bosker and Matthee, 2010; Neto and Romeu, 2011; Haddad et al. 2013) as well as international financial institutions have underlined the importance of export product diversification for promoting economic growth, reduce vulnerability to external shocks, and ultimately promote development. Hausman et al. (2007) have demonstrated that the nature of export specialization is key for economic performance, as specialization in the export of a relatively few number of products is associated with higher economic performance, when the products are of high quality. This is particularly relevant for Low-Income Countries (LICs) that experience the highest export product concentration on primary commodities in the world, which makes their economies vulnerable to the fluctuations of the prices of commodities, and hence increases their exposure to external shocks.

The present article purports to add to the macro-literature on inclusive growth, and more particularly to the role of trade on inclusive growth, by examining the interplay between export product diversification and trade policy on inclusive growth. We believe that this is the first article that addresses the topic. Additionally, in contrast with other existing macroeconomic studies that have merely relied on a static model specification and use traditional econometric estimators such as the fixed effects estimator, the current analysis relies on a dynamic model specification to analyse how export product diversification and trade policy interact in influencing inclusive growth. In so doing, it uses the two-step system Generalized Methods of Moments (GMM) to perform the empirical analysis.

The empirical analysis uses a dataset of 109 developing over the period 1995-2015 and shows that export product diversification and trade policy liberalization are complementary in promoting inclusive growth for high degrees of trade policy liberalization.

The remainder of the paper contains 5 sections. Section 2 provides a theoretical discussion on how export product diversification and trade policy liberalization could interact in influencing inclusive growth. Section 3 lays out the model specification that would help the issue at hand. Section 4 discusses the econometric technique to estimate this model. Section 5 interprets the empirical results, while Section 6 concludes.

## **2. THEORETICAL DISCUSSION ON THE EFFECT OF EXPORT PRODUCT CONCENTRATION AND TRADE POLICY LIBERALIZATION ON INCLUSIVE GROWTH**

### **2.1. Effect of Export Product Concentration on Inclusive Growth**

We discuss some channels through which export product diversification could affect inclusive growth. As export product diversification could help promote economic growth (Redding, 1999; Hummels and Klenow, 2005; Hausman et al., 2007; Bernard et al. 2007; Hesse, 2008; Cadot et al., 2011), it could lead to higher inclusive growth especially if the pay-offs of the economic growth are redistributed. Furthermore, export product diversification could reduce economic growth volatility (see Haddad, 2011), and hence, help avoid a sudden fall in the income of the poor people (in case of adverse shocks), in which case, the income inequality would increase. Thus, export product diversification could help promote inclusive growth, not only through higher economic growth, but also through lower economic growth volatility.

By creating additional trade opportunities and generating higher profits for domestic trading firms, export product diversification could help create jobs and/or generate higher wages, including for poor people. This would in turn induce higher domestic consumption and investment, which could translate into higher economic growth. Additionally, all things being equal, a rise in firms' profits, higher jobs and/or a rise in wages for traders and workers in trading firms could contribute to reducing income inequality. Both higher economic growth and decline in income inequality would result in greater inclusivity of economic growth.

The afore-mentioned possible higher domestic consumption due to export product diversification would result in higher value added tax revenue. Furthermore, the positive impact effects of export product diversification on trading firms' profits, jobs creation and eventually higher wages, could lead to higher individual income and corporate tax revenue. In developing countries, and particularly LDCs where trade tax revenue still remains an important share of total public revenue, export product diversification may generate through the channels highlighted above, higher imports (both by producers and consumers) and hence higher tariffs revenue for

the governments. Overall, we postulate that export product diversification would lead to higher public revenue (Gnanon and Brun, 2017), and allow governments to develop appropriate programmes (or adopt appropriate policies) that would help *inter alia*, protect poor people against the negative consequences of adverse shocks, and hence avoid situations of sudden fall in their income, which could increase income inequality. This would ultimately result in lower income inequality, higher economic growth, and greater inclusive growth.

Notwithstanding all channels mentioned above, one could argue that as a higher level of export product concentration induces a higher exposure to external shocks, governments in concerned countries might be willing to develop social programmes so as to mitigate the negative effects of adverse shocks that would hit their economy. In this context, export product concentration could be associated with higher inclusive growth.

## **2.2. Effect of Trade Policy Liberalization on Inclusive Growth**

While domestic trade liberalization could influence inclusive growth through many channels, we highlight here some of these avenues<sup>3</sup>, drawing from many studies including, *inter alia*, Winters (2000); Mc Culloch et al., (2001); Winters et al. (2004); Guillermo and Olarreaga, 2006; Turner et al., 2008; and UNECAP (2013).

First, as economic growth is the basic (or pre-requisite) ingredient for promoting inclusive growth, we discuss here how trade liberalization could contribute to achieving higher economic growth. While the literature has largely explored how international trade<sup>4</sup>, including trade openness influences economic growth, few empirical studies have explored the impact of trade liberalization on economic growth. The benefits of trade liberalization include, *inter alia*, the reallocation of resources from comparative disadvantages areas (where resources may be redundant) into comparative advantage areas, which helps the income to move towards its steady state level; greater economies of scale and scope, lower prices and an expansion of the range of quality products available to domestic producers and consumers, higher FDI inflows (Lee, 1995; Falvey et al., 2012). From the empirical perspective, the effect of trade liberalization on economic growth has been mixed. While some studies (Papageorgiou et al. 1991; Salinas and Aksoy, 2006; Christiansen et al. 2013; Naito, 2017) have reported a positive effect, others such as Greenway (1998) have obtained that the effect of trade liberalization on economic growth can be positive or negative.

Second, trade liberalization could affect households (both consumers and producers) through changes in prices of goods (and services) as well as households' income. Indeed, by reducing the prices of final goods (including through import competition), trade liberalization would allow consumers to have access to cheaper imported goods, and producers to

benefit from lower costs of the intermediated imported inputs used in the process of production of final goods and services (some being exported). Lower prices of imported goods and services could increase the consumers' disposable income and contribute to higher inclusive growth. The access of producers to lower costs of imported inputs would enhance the concerned country's price and even product quality competitiveness, in particular for traders. At the same time, if producers reflect the lowering of inputs costs in the prices of final goods and services, consumers will also benefit from lower domestic prices of final goods and services. All these would contribute to enhancing the inclusiveness of growth, including by reducing income inequality.

Third, trade liberalization could positively affect public revenue (Ebrill et al., 1999; Thomas and Treviño, 2013; and Brun et al., 2015). This would in turn, help governments adopt better redistribution policies that would help losers adjust to the adverse effects of domestic trade liberalization. In addition, higher public revenue could allow governments to (better) assist Micro and Small and Medium (MSMEs) to enhance their competitiveness in both domestic and international trade markets.

Fourth, trade policy liberalization could promote foreign direct investment (FDI) inflows, including those that seek to invest in the host countries' foreign trade sector (Greenway et al., 2007; Martens, 2008). By creating jobs, these FDI inflows would improve the income level of the population, notably that of poor people. Additionally, the transfer of technology, the know-how, and management practices that accompany FDI inflows could contribute to innovation in the host countries, and hence boost local people income. All these would likely promote inclusive growth.

From an empirical perspective, the majority of the existing macroeconomic empirical studies on inclusive growth<sup>5</sup> has focused on the link between trade openness (rather than trade liberalization) and inclusive growth (see the studies cited above). The empirical findings remain mixed. Dollar and Kraay (2002) have obtained that trade openness induces higher overall incomes in a country and the poorest fifth's average incomes. Aoyagi and Ganielli (2015) have found that trade openness is conducive to inclusive growth. Kang et al. (2017) have explored whether Korea's growth-driven trade policies during its industrialisation have contributed to output growth and better income distribution. They have reported that while recent trade reforms in Korea attempted to achieve a more balanced distribution of gains from trade, they were not sufficient to promote a well-balanced welfare state in the Korean economy. Furthermore, their study has shown that trade promotes growth, but only through output growth effects, rather than through income distribution. Other studies were less optimistic. Son and Kakwani (2008) have uncovered a non-significant effect of trade openness on pro-poor growth. The analysis conducted by APEC (2015) has shown that the effect of trade openness (measured in terms of growth of

<sup>3</sup> For example, see Figure 8.2 in UNESCAP (2013: p100).

<sup>4</sup> See for example, Singh (2010) and Salvatore (2011) for a survey on the relationship between international trade and economic growth.

<sup>5</sup> See APEC (2015) for an interesting literature review on trade openness and inclusive growth.

trade) on inclusive growth in Asia-Pacific Economic Cooperation (APEC) economies is far from being conclusive. The analysis has observed, inter alia, that trade does not seem to directly contribute to inclusive growth, although evidence has been found that trade is more likely to directly benefit more well-off segments of the population. It concludes that as trade creates winners and losers, this does not imply that inclusive growth is neither a natural, nor a necessary outcome of trade. Rather, to ensure that trade is inclusive vis-à-vis the overall economy, trade openness should be accompanied with structural reforms in other areas, such as investment in human capital, social protection, labour market, financial market and institutional reforms.

On another note, some scholars (Rodrik, 1997, 1999; Avelino et al., 2005; Fiszbein et al., 2009; Nooruddin and Rudra, 2014) have reported that a high exposure of developing countries to the adverse consequences of trade or financial liberalization would likely lead governments of these countries to provide transfers to key interest groups to ensure stability and prevent backlash against globalization. In a similar vein, Desai and Rudra (2018) investigate the effects of trade balances in agricultural and manufactured goods on social protection and obtain evidence that better social protection is provided by net food and agricultural exporters than by countries that experience agricultural trade deficits. Additionally, countries with manufacturing trade surpluses have shown a reduced social protection coverage. The authors explain these results by the fact that in net agricultural exporting countries, governments tend to invest in social programs that covers the rural poor, whereas in manufacturing countries, which are likely participants in global production chains, governments provide lower social protection. Against this background, we could expect that countries with higher level of export product diversification would provide lower social protection (and hence allocate lower share of their overall public expenditure to social protection) than countries with a relatively lower export product diversification level (i.e., countries with a relatively higher level of export product concentration). Thus, all thing being, a higher export product diversification could lead to lower inclusive growth, whereas a rise in export product concentration would induce higher inclusive growth.

**2.3. How Could the Effect of Export Product Concentration on Inclusive Growth Could Depend Trade Policy Liberalization?**

In light of the discussion in Sections 2.1 and 2.2., we examine here how export product concentration and trade policy liberalization could interact in influencing inclusive growth.

On the one hand, we argue that if export product diversification promotes inclusive growth (through the channels highlighted in Section 2.1), then trade restrictive measures would likely undermine the export production diversification process, and ultimately hurt inclusive growth promotion. In this context, for export product diversification to achieve inclusive growth, it should be accompanied by greater trade policy liberalization. As a result, we formulate the hypothesis 1 that export product diversification and trade

policy liberalization are complementary in promoting inclusive growth.

On the other hand, if higher export product concentration results in higher inclusive growth (because governments have developed social programmes to limit or mitigate any eventual negative effects of shocks on poor segments of the population), then greater trade policy liberalization could further expose the countries in question to external shocks, and possibly lead to lower inclusive growth. In this scenario, higher level of export product concentration (i.e., lower level of export product diversification) would be associated with inclusive growth if accompanied by lower degree of trade policy liberalization. In this context, our second hypothesis (hypothesis 2) is that export product concentration and trade protectionism are complementary in promoting inclusive growth. The only limit associated with this scenario is that protracted trade restrictive measures could ultimately hurt economic growth, even though they intend to protect some industries or particular sectors of the economy, for example from job losses.

Overall, it is hard to anticipate the direction in which export product concentration (or export product diversification) and trade policy liberalization interact in influencing economic growth.

**3. MODEL SPECIFICATION**

To examine how export product diversification and trade policy liberalization interact in influencing inclusive growth, we follow existing studies on the macroeconomic determinants of inclusive growth (Son and Kakwani, 2008; Anand et al. 2013; APEC, 2015; Aoyagi and Ganelli, 2015; Aoyagi et al. 2016; and Kang et al. 2017) and measure inclusive growth as the income growth adjusted by changes in income inequality.

Following these empirical studies, we postulate the baseline model:

$$\begin{aligned}
 INCLUSGR_{it} = & \alpha_0 + \alpha_1 INCLUSGR_{it} + \alpha_2 ECI_{it} + \alpha_3 TP_{it} + \alpha_4 [ECI_{it} * TP_{it}] + \\
 & \alpha_5 Log(INF)_{it} + \alpha_6 Log(INF)_{it}^2 + \alpha_7 GFCF_{it} + \alpha_8 FINDEV_{it} + \alpha_9 INST_{it} + \mu_i + \\
 & \gamma_t + \omega_{it}
 \end{aligned}
 \tag{1}$$

where *i* stands for the country's index; *t* is the annual time-period.  $\alpha_0$  to  $\alpha_9$  are parameters to be estimated.  $\mu_i$  represents countries' fixed effects;  $\omega_{it}$  is a well-behaving error-term.  $\gamma_t$  represents global shocks that influence all countries' inclusive growth patterns. The panel dataset used is unbalanced and contains 109 developing countries over the period 1995-2015. To limit the effect of business cycles on the variables, we follow the practice in the empirical literature and use 7 non-overlapping sub-periods of 3-year average data. These include the sub-periods 1995-1997; 1998-2000; 2001-2003; 2004-2006; 2007-2009; 2010-2012 and 2013-2015.

The dependent variable "INCLUSGR" stands for the measure of inclusive growth and is the difference between the real per

capita income and the change in the net GINI index. The one-period lag of this variable has been introduced in model (1) as a regressor in order to capture the persistence (i.e., the state-dependence) in inclusive growth, due to the state-dependence in economic growth (Falvey et al., 2012; Christiansen et al. 2013) and in income inequality (Bergh and Nilsson, 2010; Johansson and Wang, 2014). The definition and sources of the other variables are presented in Appendix 1. Appendix 2 shows the descriptive statistics on the variables used in model (1). Appendix 3 contains the list of countries in the full sample.

The key variable of interest "ECI" stands for the Herfindahl-Hirschmann Index of export product concentration (see Appendix 1 for further details on the computation of this index). Its values range from 0 to 1, with higher values reflecting a higher export product concentration (or lower export product diversification), and lower values indicating lower export product concentration (or higher export product diversification).

Control variables included in this model are those deemed to influence the effect of export product diversification on inclusive growth.

"TP" is the indicator of domestic trade liberalization. It is measured by the "freedom to trade internationally" (see Miller et al., 2017). This index includes both tariffs and non-tariff measures. For example, the traditional measure of trade openness (i.e., the share of the sum of exports and imports of goods and services to GDP) does not purely reflect trade liberalization, but rather the outcome of several domestic policies – of which trade liberalization - along with countries' structural factors such as their geographical location., their endowments.....etc.

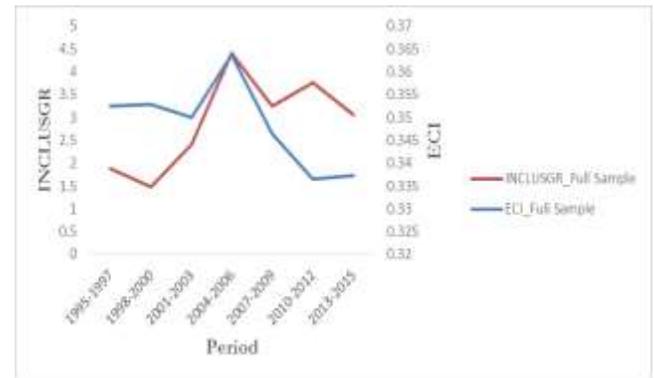
Inflation rate (denoted "INF") is expected to be non-linearly associated with higher inclusive growth, as following Aoyagi et al., (2017), it could be possible that inflation rate would reduce inclusive growth once it reaches a minimum level. To limit the skewness of the inflation variable, and retain information related to zero and negative observations, this variable has been transformed into Logarithm using equation (2) (see Yeyati et al. 2007):  $Y = \text{sign}(X) * \log(1 + |X|)$  (2), where "X" is the variable to be transformed.

Higher domestic investment (denoted "GFCF") is expected to influence positively inclusive growth.

The variable "FINDEV" aims to capture the role of financial development depth on inclusive growth (see also Kang et al., 2017). The variable representing the institutional and governance quality (denoted "INST") is expected to influence positively inclusive growth. This variable has been calculated using the Principal Component Analysis. We have considered this variable as exogenous because it changes little over time, and additionally, the use of the factor analysis severely mitigates the simultaneity bias concern (see a similar argument in Portugal-Perez and Wilson, 2012). The other variables are considered as exogenous.

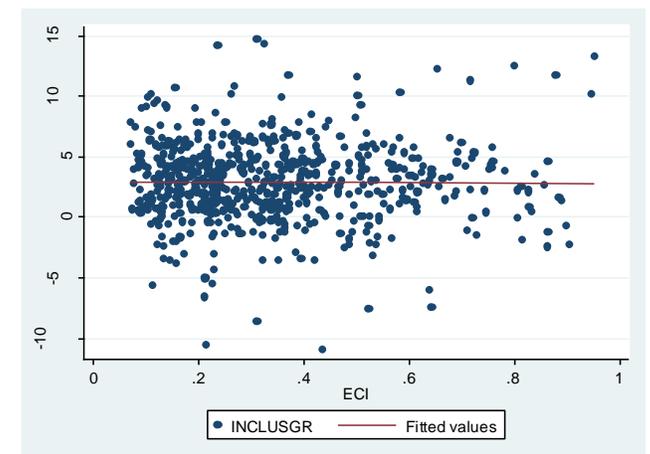
To get an idea on the relationship between export product concentration and inclusive growth, we compare in Fig. (1) the

evolution of inclusive growth and export product concentration over the full sample. This Figure shows that both export product concentration and inclusive growth evolve in the same direction over the considered period. Specifically, these countries experience on average higher level of export product concentration, and an increase in the average inclusive growth from 1995-1997 to 2004-2006, period during which they reach their maximum level of both export product concentration and inclusive growth. From 2004-2006 to 2013-2015, the degree of export product concentration has declined, thereby reflecting higher levels of export product diversification. At the time, has also declined. In Fig. (2), we present the cross-plot between export product concentration and inclusive growth over the full sample. The correlation pattern between these two variables is not clear.



Source: Author

**Fig. (1).** Evolution of average ECI and average INCLUSGR.



Source: Author

**Fig. (2).** Cross-plot between ECI and INCLUSGR \_Using non-overlapping sub-periods of 3-year average data.

#### 4. ECONOMETRIC STRATEGY

In the first instance, we use standard econometric estimators to examine empirically how export product concentration and trade policy liberalization, taken separately influence inclusive growth. To do so, we draw on previous studies on the macroeconomic determinants of (and in particular the impact of) trade openness/trade policy liberalization inclusive growth (Anand et al. 2013, APEC, 2015, Aoyagi and Ganelli, 2015, Aoyagi et al. 2016 and Kang et al. 2017) and estimate model (1)

in a static form (i.e., without the one-period lag of the dependent variable), using the within fixed effects estimator, denoted 'FE-DK'. Standard errors are corrected by the Driscoll and Kraay (1998) technique (see Hoechle 2007). We first estimate the static form of model (1) with "INCLUSGR" as the dependent variable. The results of this estimation are provided in column [1] of Table 1. We additionally follow previous studies (Aoyagi et al. 2016; Kang et al. 2017), and report the results of the estimation of the static version of model (1) using the 'FE-DK' where the dependent variable is respectively the growth rate of the real per capita income (denoted "GDPCAPGR") and the growth of the net GINI index (denoted "GINIGR"). The outcomes of these estimations are presented in columns [2] and [3] of Table 1.

**Table 1: Impact of export product concentration on inclusive growth.**

**Estimator: Within Fixed Effects with Driscoll-Kraay (1998) Standard Errors.**

Variables	Inclusgr	Gdpcapgr	Ginigr
	(1)	(2)	(3)
ECI	2.980***	3.861***	0.0524
	(0.989)	(0.743)	(0.559)
TP	0.0261***	-0.00302	-0.0122***
	(0.00943)	(0.0106)	(0.00127)
Log(INFL)	0.606*	0.320	-0.261***
	(0.350)	(0.255)	(0.0763)
[Log(INFL)] <sup>2</sup>	-0.263***	-0.170**	0.0539***
	(0.0869)	(0.0734)	(0.0164)
GFCF	0.128***	0.109***	-0.0139***
	(0.00742)	(0.0210)	(0.00459)
FINDEV	-0.0375**	-0.0386**	-0.00396**
	(0.0175)	(0.0178)	(0.00177)
INST	0.0303	-0.0389	-0.0389
	(0.129)	(0.283)	(0.0750)
Constant	-1.147	0.407	1.247***
	(1.503)	(1.672)	(0.258)
Observations	586	672	586
Number of groups	109	109	109
Within R-squared	0.1311	0.1063	0.0659

Note: \*p-value<0.1; \*\*p-value<0.05; \*\*\*p-value<0.01. Robust Standard Errors are in parenthesis.

As the variable of primary interests ("ECI"), as well as control variables "TP", "Log(INFL)", its square term, "GFCF" and "FINDEV" could be potentially endogenous due inter alia to the simultaneity biases, the estimates provided in Table 1 could be biased. In addition, the static version of model (1) may suffer from the omitted variable bias, notably the bias associated with the absence of the one-period lag of the dependent variable as a right-hand side variable. To address all these endogeneity concerns, we use the two-step system Generalized Methods of Moments (SGMM), proposed by Arellano and Bover (1995) and Blundell and Bond (1998) for dynamic panels with a small-time dimension and large cross-section to estimate model (1). The use of the SGMM approach entails the estimation of a system of equations containing an equation in differences with an equation in levels where lagged first differences of endogenous variables are treated as instruments for the levels equation and where lagged levels of endogenous variables are used as instruments in the first-difference equation.

The consistency of the SGMM estimator is assessed through several diagnostic tests: the Arellano-Bond test of first-order serial correlation in the error term (denoted AR(1)); the Arellano-Bond test of absence of second-order autocorrelation in the error term (denoted AR(2)); and the Sargan test of over-identifying restrictions, which helps check the validity of the instruments used in the estimations. We also indicate the number of instruments used in the regressions, as a higher number of instruments in the regressions than the number of countries could reduce the power of the afore-mentioned tests (Bowsher, 2002; Roodman, 2009). Note that in estimating the dynamic model (1), the variables "ECI", "TP", "Log(INFL)", its square term, "GFCF" and "FINDEV" have been considered as endogenous.

Overall, the analysis based on the SGMM approach is performed as follows. First, we examine how export product diversification and trade policy liberalization influence separately inclusive growth. To do so, we estimate the dynamic specification of model (1), but without the interaction variable between "HHI" and "TP" variables over the full sample, using the SGMM estimator. The results of this estimation are reported in column [1] of Table 2. We additionally estimate the same model specification by replacing the dependent variable "INCLUSGR" with its components, which are "GDPCAPGR" and "GINIGR". The results of the estimations of these variants of model (1) are displayed in columns [2] and [3] of Table 2, with the dependent variable being respectively "GDPCAPGR" and "GINIGR". Second, we now analyse how export product diversification and trade policy liberalization interact in influencing inclusive growth. This amounts to estimating model (1) as it stands by means of the SGMM approach. The results of this estimation are presented in column [1] of Table 3. For robustness check of these results, we have replaced the variable "TP" in model (1) with the traditional measure of trade openness, which is the ratio of the sum of exports and imports of goods and services in percentage of GDP. The resulting model is estimated using the SGMM technique, and the outcome of the estimation is provided in column [2] of Table 3.

**Table 2: Impact of export product concentration on inclusive growth.***Estimator: SGMM*

Variables	Inclusgr	Gdpcapgr	Ginigr
	(1)	(2)	(3)
One-period lag of the dependent variable	0.130***	0.148***	0.769***
	(0.0213)	(0.0132)	(0.0127)
ECI	5.740***	6.347***	0.281**
	(1.127)	(0.746)	(0.135)
TP	0.0648***	0.0703***	0.00473*
	(0.0153)	(0.0156)	(0.00244)
Log(INFL)	3.112***	1.708***	-0.293***
	(0.361)	(0.249)	(0.0416)
[Log(INFL)] <sup>2</sup>	-0.702***	-0.443***	0.0271***
	(0.0749)	(0.0553)	(0.00754)
GFCF	0.0570***	-0.00942	0.0148***
	(0.0135)	(0.0126)	(0.00300)
FINDEV	-0.0262***	-0.0209***	0.00530***
	(0.00606)	(0.00629)	(0.000753)
INST	0.509***	0.977***	-0.189***
	(0.195)	(0.197)	(0.0278)
Constant	-6.596***	-4.856***	-0.821***
	(1.417)	(1.343)	(0.238)
Observations - Countries	500 - 109	500 - 109	500 - 109
Number of Instruments	81	81	101
AR1 (P-Value)	0.0019	0.0000	0.0001
AR2 (P-Value)	0.3774	0.7462	0.1364
AR3 (P-Value)	0.5389	0.4909	0.9255
Sargan (P-Value)	0.2343	0.1802	0.4429

Note: \*p-value<0.1; \*\*p-value<0.05; \*\*\*p-value<0.01. Robust Standard Errors are in parenthesis. In the SGMM estimations, the variables "ECI, TP, Log(INFL), its square term, GFCF, FINDEV" have been considered as endogenous.

## 5. INTERPRETATION OF EMPIRICAL RESULTS

Results displayed in column [1] of Table 1 show that export product concentration is positively associated with inclusive growth. Results in columns [2] and [3] show that the outcome obtained in column [1] concerning the effect of export product concentration on inclusive growth is driven by a positive impact export product concentration on economic growth, and a statistically nil impact of export product concentration on growth of inequality. Trade policy liberalization is conducive to higher inclusive growth (see column [1]), including through a

negative and significant effect on growth in inequality (see column [3]). Incidentally, trade liberalization exerts no significant impact on economic growth (see column [2]). Inflation rate appears to be non-linearly related to inclusive growth, as well as economic growth and growth in inequality. In particular, at the 5% level, it is consistently associated with lower inclusive growth and per capita income growth, while at the same time, it generates a rise in income inequality growth after a certain level. Domestic investment is positively associated with inclusive growth, and negatively related to the growth of income inequality. Financial development is negatively and significantly associated with inclusive growth, per capita income growth rate, and income inequality growth rate. Finally, better institutional and governance quality exerts no significant impact on inclusive growth. It is worth noting that while these findings represent average effects over the full sample, they likely reflect differentiated effects across countries in the entire sample (which is highly heterogeneous).

As noted above, these results may be biased because the variable of interest as well as some control variables (highlighted above) are likely endogenous. Therefore, outcomes in Table 1 could be less relevant for our analysis than those reported in Tables 2 and 3.

**Table 3: Does the effect of "ECI" on inclusive growth depend on the level of trade policy liberalization/Trade Openness?***Estimator: SGMM*

Variables	INCLUSGR	INCLUSGR
	(1)	(2)
INCLUSGR <sub>t-1</sub>	0.143***	0.125***
	(0.0216)	(0.0171)
ECI	10.28***	5.481***
	(1.885)	(0.980)
ECI*TP	-0.130***	
	(0.0314)	
ECI*OPEN		-0.0238**
		(0.0105)
TP	0.137***	
	(0.00893)	
OPEN		0.0293***
		(0.00548)
Log(INFL)	1.846***	2.498***
	(0.276)	(0.319)
[Log(INFL)] <sup>2</sup>	-0.421***	-0.669***
	(0.0592)	(0.0701)
GFCF	0.0932***	0.0608***
	(0.0114)	(0.0130)

FINDEV	-0.0230*** (0.00508)	-0.0242*** (0.00375)
INST	0.0961 (0.163)	0.101 (0.133)
Constant	-10.77*** (1.003)	-4.201*** (0.567)
Observations - Countries	500 - 109	515 - 109
Number of Instruments	91	94
AR1 (P-Value)	0.0003	0.0004
AR2 (P-Value)	0.4242	0.2514
AR3 (P-Value)	0.4561	0.4234
Sargan (P-Value)	0.4719	0.2517

Note: \*p-value<0.1; \*\*p-value<0.05; \*\*\*p-value<0.01. Robust Standard Errors are in parenthesis. In the SGMM estimations, the variables "ECI, TP, Log(INFL), its square term, GFCE, FINDEV" have been considered as endogenous.

Let us now turn to the outcomes displayed in Tables 2 and 3. The results concerning the one-period lag of the variable "INCLUSGR" (in these two Tables), the variables "GDPCAPGR" and "GINIGR" (in Table 2) are positive and statistically significant at the 1% level, thereby suggesting that these variables are persistent over time (i.e., they are state-dependent). Incidentally, across all columns of Tables 2 and 3, we find that the p-values associated with the AR(1) test are 0 across all columns, while the p-values relating to AR (2) and AR(3) tests are higher than 0.10. Moreover, the p-values associated with the Sargan test are higher than 0.10. Taken together, these suggest that the outcomes of the diagnostic tests that help check the validity of the SGMM approach are satisfactory, and that the SGMM estimator is appropriate for the estimation of different variants of model (1).

Taking up now the estimates in Table 2, we obtain that export product concentration is positively and significantly (at the 1% level) associated with inclusive growth (see column [1] of Table 2). At the same time, trade policy liberalization exerts a positive and significant impact (at the 1% level) on inclusive growth. Specifically, a 1-point increase in the ECI indicator is associated with a 5.7 percentage point increase in the index of inclusive growth, while a 1-point increase in the index of trade policy results in 0.065 percentage point increase in inclusive growth. Results in column (2) show that export product concentration induces higher economic growth. This result runs against the finding of Hesse (2008) that export product diversification is associated with a positive economic growth. The difference between our outcome and that of Hesse (2008) may possibly be explained by the time span of the data used, which is 1965-2000 for Hesse (2008) and 1995-2015 in the present study. In the meantime, export product diversification helps reduce income inequality growth (the coefficient of the ECI variable is positive and statistically significant at the 5%

level in column [3]). Trade policy liberalization promotes real per capita income growth. However, its positive effect on income inequality growth is statistically significant only at the 10% level. As for control variables, we observe across the three columns of Table 2 that, inflation is non-linear related to inclusive growth (as expected), whereby inflation induces lower inclusive growth only if it reaches a certain level, which is 4.4% (= 3.112/0.702), according to estimates in column [1]. Likewise, inflation is also non-linearly associated with economic growth and income inequality growth, as beyond a certain maximum level, it reduces economic growth and induces higher income inequality.

Better institutional and governance quality exert a positive and significant effect on inclusive growth (see results in the three columns of Table 2) on economic growth, but a negative effect on income inequality growth. However, financial development is negatively related to inclusive growth as well as economic growth, and generates higher income inequality growth. These surprising results certainly hide different effects across countries in the full sample, which as we noted above is highly heterogenous. While domestic investment influences positively and significantly inclusive growth, it does not influence significantly economic growth (although this surely hides various effects across countries in the full sample), but surprisingly, it exerts a positive impact on the income inequality growth rate. This peculiar effect may be explained by the fact that an eventual positive effect of domestic investment on income inequality growth could be dependent on other factors.

We now consider results in Table 3. As noted earlier, we are interested here on the interplay between export product concentration and trade policy in influencing inclusive growth. As a result, two key coefficients are of interest here: the coefficient of the variable "ECI" and the interaction term associated with the variable "ECI\*TP". It is worth noting here that according to Appendix 2, the values of the trade policy index range between 13.4 and 89.2. Results in column [1] of the Table indicate that the coefficient of "ECI" is positive and statistically significant at the 1% level, whereas the interaction term is negative and significant also at the 1% level. Taking together, these two results suggest that there is a turning point for the level of trade policy liberalization above which the total effect of export product concentration on inclusive growth becomes negative. This turning point of the index TP is given by 79.07 [=10.28/0.130]. This therefore suggests that for levels of trade policy liberalization lower than the threshold 79.07, export product concentration exerts a positive effect on inclusive growth, i.e., export product concentration and trade policy liberalization are substitutable, and the lower the degree of trade policy liberalization, the higher the magnitude of the positive effect of export product concentration on inclusive growth. In other words, when the level of trade policy liberalization is lower than 79.07, export product concentration is complementary with trade policy liberalization. In contrast, when the degree of trade policy liberalization exceeds the threshold of 79.07, it is export product diversification that induces higher inclusive growth in the context of greater trade

policy liberalization. Thus, above the threshold 79.07, export product diversification and trade policy liberalization are complementary in promoting inclusive growth, and the greater the degree of trade policy liberalization, the higher the magnitude of the positive effect of export product diversification on inclusive growth.

Turning to results in column [2] of Table 3, we note that results go in the same direction as the ones observed in column [1] concerning ECI and the interaction variable "ECI\*OPEN". In particular, we note from results in column [2] of Table 3 that the coefficient of "ECI" is positive and statistically significant at the 1% level, whereas the interaction term is negative and significant also at the 5% level. It is worth mentioning that the values of the variable "OPEN" range between 16.3% and 279.3%. The combination of these two outcomes therefore suggest that above 230.3% ( $=5.481/0.0238$ ) for the trade openness variable, it is export product diversification that results in higher inclusive growth, whereas below this threshold, it is export product concentration that induces higher inclusive growth. Thus, once again, it is for very high levels of trade openness that export product diversification induces higher inclusive growth. Otherwise (for lower levels of trade openness), it is export product concentration that is positively associated with inclusive growth.

Estimates associated with control variables in Table 3 are to a large extent consistent with those obtained in column [1] of Table 2.

## 6. CONCLUSION

This paper examines the interplay between export product diversification and trade policy liberalization in influencing inclusive growth, using an unbalanced dataset of 109

developing countries over the period 1995-2015. The findings indicate that export product diversification is complementary with inclusive growth for very high levels of trade policy liberalization or trade openness. For low levels of trade policy liberalization or trade openness, export product concentration is associated with inclusive growth. One take-home message from this analysis is that as countries experience a higher level of diversification of their export product basket, they should further open up their trade regimes so as to ensure the inclusiveness of their economic growth. These results therefore suggest that one way for promoting inclusive growth in developing countries is to promote the diversification of their export product baskets, while concurrently further liberalize trade policies. Promoting inclusive growth and diversifying export products basket has been a key policy advice by many international organizations to developing countries. The current backlash against international trade (including between the United States of America and its trading partners) would certainly not help achieve these objectives, unless they try to settle their trade disputes through better cooperation on international trade matters so as to maintain international trade markets open.

## CONFLICT OF INTEREST

The authors declare no conflicts of interest.

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## Appendix 1: Definition and Source of variables.

Variables	Definition	Source
INCLUSGR	It is the indicator of Inclusive Growth. It is measured by income growth (Real GDP Growth rate) adjusted by changes in income Inequality. $INCLUSGR = \text{real GDP per capita growth} - \text{changes in net GINI}$	Author's calculation. Data on Real GDP per capita growth rate comes from the World Development Indicators, 2017 of the World Bank (WDI). Income inequality data refers to Gini index extracted from the Standardizing the World Income Inequality Database (SWIID). Net GNI is net (after taxes and transfers) inequality.
GDPCAPGR	This is the growth rate (%) of the real per capita GDP	World Development Indicators (WDI)
GINIGR	This is the growth rate (%) in the net GNI is net (after taxes and transfers) inequality.	Author's calculation based on data from the Standardizing the World Income Inequality Database (SWIID).
ECI	This is the Export Product Concentration Index. It is calculated is calculated using export products at 3-digit group level, based on the Standard International Trade Classification (SITC) Revision 3. Its values are normalized so that they range between 0 and 1. An index value closer to 1 indicates a country's exports or imports are highly concentrated on a few products. On the contrary, values closer to 0 reflect exports are more homogeneously distributed among a series of products.	United Nations Conference on Trade and Development (UNCTAD) Database. See online: <a href="http://unctadstat.unctad.org/wds/TableViewer/tableView.aspx?ReportId=120">http://unctadstat.unctad.org/wds/TableViewer/tableView.aspx?ReportId=120</a>

TP	Trade Policy of the domestic economy (Domestic Trade Policy). It is measured by the Trade Freedom Score; This is a component of the Economic Freedom Index. It is composite measure of the absence of tariff and non-tariff barriers that affect imports and exports of goods and services. This score is graded on a scale of 0 to 100, with a rise in its value indicating lower trade barriers, i.e., higher trade liberalization, while a decrease in its value reflects rising trade protectionism.	Heritage Foundation (see Miller et al., 2017)
OPEN	This is the measure of trade openness. It is the ratio of the sum of exports and imports of goods and services, in percentage of GDP.	World Development Indicators (WDI)
GDPC	GDP per capita (constant 2010 US\$)	WDI
INF	Inflation rate (in annual %), based on Consumer Price Index. We replace missing data by data on Inflation, GDP deflator (annual %).	Author's calculation based on data from WDI
FINDEV	It is the domestic credit to private sector (% of GDP). It acts as a proxy for It stands for the measure of the depth of domestic financial development.	WDI
GFCF	Gross fixed capital formation (% of GDP)	WDI
INST	This is the variable capturing institutional and governance quality in a given country. It has been computed by extracting the first principal component (based on factor analysis) of the following six indicators of governance and institutions quality. These indicators include political stability and absence of violence/terrorism; regulatory quality; rule of law; government effectiveness; voice and accountability, and corruption.  It is worth noting that the values of each of these indicators range from - 2.5 to +2.5, with the lower values being associated with 'worse' governance and institutional quality, and the higher values being associated with 'better' institutional and governance quality.	Data on the components of 'INST' variable has been extracted from World Bank Governance Indicators developed by Kaufmann et al. (2010) and recently updated.

**Appendix 2: Standard Descriptive statistics on the variables used in the analysis.**

Variable	Observations	Mean	Standard deviation	Minimum	Maximum
INCLUSGR	542	3.370	3.938	-9.292	16.938
GINIGR	542	-0.574	2.776	-13.984	14.377
GDPCAPGR	652	2.595	3.208	-10.683	18.627
ECI	649	0.348	0.198	0.070	0.956
TP	619	65.544	13.090	13.400	89.167
OPEN	749	79.619	35.032	16.281	279.334
INFL	651	22.761	320.878	-4.987	8162.226
GFCF	632	22.410	8.212	2.234	66.750
FINDEV	643	32.731	27.947	0.001	149.241
INST	650	-1.130	1.287	-5.119	2.118

**Appendix 3: List of countries used in the full sample.**

Full Sample			
Albania	Dominican Republic	Mali	Suriname
Algeria	Ecuador	Mauritania	Swaziland
Angola	Egypt, Arab Rep.	Mauritius	Syrian Arab Republic
Argentina	El Salvador	Mexico	Tajikistan

Armenia	Fiji	Moldova	Tanzania
Bangladesh	Gambia, The	Mongolia	Thailand
Belarus	Georgia	Montenegro	Timor-Leste
Belize	Ghana	Morocco	Togo
Benin	Guatemala	Mozambique	Tonga
Bhutan	Guinea	Namibia	Tunisia
Bolivia	Guinea-Bissau	Nepal	Turkey
Bosnia and Herzegovina	Guyana	Nicaragua	Uganda
Botswana	Haiti	Niger	Ukraine
Brazil	Honduras	Nigeria	Vanuatu
Bulgaria	India	Pakistan	Venezuela, RB
Burkina Faso	Indonesia	Panama	Vietnam
Burundi	Iran, Islamic Rep.	Papua New Guinea	Yemen, Rep.
Cabo Verde	Jamaica	Paraguay	Zambia
Cambodia	Jordan	Peru	Zimbabwe
Cameroon	Kazakhstan	Philippines	
Central African Republic	Kenya	Romania	
Chad	Kyrgyz Republic	Russian Federation	
China	Lao PDR	Rwanda	
Colombia	Lebanon	Senegal	
Congo, Dem. Rep.	Lesotho	Serbia	
Congo, Rep.	Liberia	Sierra Leone	
Costa Rica	Macedonia, FYR	South Africa	
Cote d'Ivoire	Madagascar	Sri Lanka	
Djibouti	Malawi	St. Lucia	
Dominica	Malaysia	St. Vincent and the Grenadines	

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