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Future of Development Cooperation Coalition



Economic Transformation and the Future of Development Cooperation

Future of Development Cooperation Coalition

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About the Future of Development Cooperation Coalition

The Future of Development Cooperation Coalition was born from high-level discussions at the June 2025 Financing for Development Conference in Sevilla, Spain. The Coalition is an independent, time-bound initiative co-chaired by Yemi Osinbajo and Arancha González Laya, and brings together nine commissioners from across government, finance, business, technology, and civil society. The Coalition has an ambitious agenda to facilitate a process through which countries at all stages of development—and leaders from across public, private, and civil society sectors—can co-create a bold vision, principles, and practical recommendations for a reimagined development cooperation system that is more effective, efficient, legitimate, fit for the future, and anchored in mutual trust.

The Coalition is supported by a small secretariat co-hosted by the Center for Global Development and the African Center for Economic Transformation.

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For more about the Coalition, visit devcoalition.org.

Executive Summary

Investing in the economic transformation of low- and middle-income countries is an investment in a more stable and prosperous world. Economies that diversify, industrialize, and create formal employment become larger markets, more reliable partners, and resilient links in global supply chains. Reorganizing development cooperation around economic transformation is therefore a matter of mutual interest.

However, the record has fallen short. Between 2000 and 2015, growth returned across most low- and middle-income economies, with average annual growth of 4.9 percent in Sub-Saharan Africa, 6.1 percent in Southeast Asia, 6.4 percent in South Asia, and 7.0 percent in Central Asia. Despite these growth rates, growth rarely translated into structural transformation. Manufacturing shares declined in most regions, commodity dependence persisted, and labor shifted into low-productivity informal services. The fall in commodity prices after 2014 exposed these vulnerabilities. The central challenge is not simply the volume of resources available, but the gap between how cooperation is delivered and what transformation requires. Despite investments in health, education, and institutional capacity, support has largely remained project based, short term, and weakly aligned with national transformation strategies, with limited links to productive investment and industrial upgrading. Cooperation must therefore be measured by whether it accelerates transformation.

Drawing on evidence from Africa, Asia, and Latin America, seven lessons emerge:

1. Economic transformation requires disciplined industrial policy that ensures performance accountability and promotes capability building.

2. Regional production integration matters more than trade integration because it provides the scale for competitive manufacturing and services as well as the pathway into global value chains.

3. Financing transformation depends on both the volume of capital and its design, sectoral allocation, and investment horizon.

4. Country ownership and accountability to domestic citizens are the foundation on which successful transformation rests.

5. Cooperation must operate on timelines consistent with transformation rather than short project cycles.

6. Sequencing matters; it determines whether cooperation instruments support or undermine a country's stage of productive development.

7. The green transition, youth employment, small and medium-sized enterprise (SME) financing, and technology adoption are transformation imperatives, not separate tracks.

These lessons in turn point to certain priorities for a cooperation ecosystem organized around transformation, including regional production integration to create scale, disciplined industrial policy to coordinate structural change, patient capital directed toward productive sectors, and accountability measured through structural transformation outcomes rather than donor outputs.

Transformation is a national project. Governments must strengthen industrial policy institutions, align national and regional priorities, and build domestic accountability. Development partners must provide predictable, long-term finance; support regional production systems; promote technology transfer; and establish mutual accountability. Experiences from other countries show that transformation happens when domestic strategy, institutional capability, and external support align. The task is to make this alignment a defining feature of development cooperation.

1. Introduction

The economic transformation imperative

Economic growth without transformation leaves low- and middle-income economies vulnerable. Research shows that low- and middle-income economies experienced a period of strong economic growth from the early 2000s to the mid-2010s.[1] This boom was driven by the commodity supercycle in resource-dependent economies and by investment, exports, and domestic demand in others. However, despite this boom, there were no major changes in the productive structure of most economies.

When the supercycle ended in 2014, growth slowed, fiscal positions weakened, and poverty reduction decelerated or partially reversed in several countries. Commodity-led growth did not generate the diversification, productive capabilities, or formal employment needed to absorb growing working-age populations and to sustain long-term productivity and income growth.

Economic transformation, not growth alone, is the foundation for resilient and inclusive development. Economic transformation is a sustained process through which economies diversify their production and export structures, reallocate resources toward higher-productivity activities, upgrade technological and organizational capabilities, and translate these changes into better jobs, higher incomes, and improved human well-being.[2]

In this broader sense, economic transformation goes beyond the classical notion of structural transformation, which focuses primarily on shifts in the composition of output and employment across sectors. The concept encompasses institutional development, human capital accumulation, economic resilience, and social inclusion.[3] Together, these broader changes enable economies to withstand external shocks, move into higher-value activities, expand employment, and sustain long-term improvements in standards of living.

To operationalize this concept, the African Center for Economic Transformation developed the "Growth with DEPTH" framework. The framework holds that growth alone is insufficient. Countries must also make progress across five dimensions: diversification beyond commodity dependence; export competitiveness in non-extractive products; economy-wide productivity growth; technology upgrading, including digital technologies and artificial intelligence (AI); and improvements in human well-being. Each dimension carries a distinct policy agenda, and the well-being dimension ties structural change to living standards rather than overall economic growth.

Development cooperation can support each of these dimensions.[4] External support can fund investment in productive sectors, strengthen the institutional capabilities needed to design and implement industrial policy, and improve the data systems needed for credible diagnostics and evidence-based policymaking. Where cooperation has worked best, external support has aligned with nationally defined transformation strategies and reinforced domestic institutions rather than bypassing them.

What transformation looks like in practice

The experiences of South Korea and Vietnam show that transformation depends on deliberate, planned industrial strategy built on macroeconomic stability and enforced through accountability for performance, rather than commodity-driven growth.

South Korea followed a clear sequencing of export-oriented light manufacturing in the 1960s, state-led promotion of heavy and chemical industries in the 1970s, and a subsequent shift toward higher-tech sectors such as electronics and semiconductors from the 1980s onward. Throughout this process, state support became increasingly conditional on export performance and was underpinned by macroeconomic stability.[5] Vietnam followed a different path: Doi Moi reforms in 1986 began with agricultural liberalization and macroeconomic stabilization before layering on industrial strategy, staging market opening alongside continued state direction, so firms built capability before full competitive exposure.[6] Vietnam's merchandise exports grew steadily from the early 2000s, reaching about $353 billion in 2023.[7] In both cases, governments designed and led their own transformation strategies, with development cooperation in a supporting role (Boxes 1 and 2 in the next section).

The experiences of low- and middle-income countries underscore the importance of sequencing. In Ethiopia, industrial parks have generated employment and export gains. However, persistent foreign exchange shortages, logistics and customs challenges, and conflict have constrained capacity utilization, discouraged investment, and limited their links to the broader economy. Industrial policy instruments cannot substitute for macroeconomic stability, institutional capacity, and basic state functionality.[8] These experiences also clarify what economic transformation is and what it is not. Four distinctions matter.

1. **Commodity-led growth should not be confused with economic transformation.** Most Central Asian economies and resource-rich Sub-Saharan African countries grew rapidly during the 2000s through natural resource rents but did not build more diverse and productive economies. In many such economies, commodities accounted for well over 70 percent of merchandise exports during the commodity boom.[9] This contrasts with the experience of resource-rich Asian economies such as Malaysia and Indonesia, which used resource revenues to support industrialization, export diversification, and technology upgrading.[10]
2. **Transformation does not mean returning to the import-substitution industrialization strategies of the 1960s and 1970s.** The earlier approaches often combined protection with weak export discipline, allowing inefficient firms to survive while serving small domestic markets. Today, the industrial policy needed for transformation should be export oriented, performance conditioned, and time limited, with the state addressing coordination failures and providing patient finance rather than owning assets or supplanting market signals.[11]
3. **Manufacturing remains important, but transformation is not confined to manufacturing.** What matters is not whether activity occurs in manufacturing or services, but whether it raises productivity, generates domestic linkages,

and creates opportunities for upgrading into more sophisticated activities over time. India's information technology and software services expansion, profiled in Box 2, illustrates the point.[12]

4. **Participation in value chains can support transformation, but integration alone is insufficient.** Sector initiatives contribute to economic transformation only when they generate productivity spillovers, create domestic linkages, and open credible paths to more complex products, functions, or services over time. Bangladesh's garment sector illustrates the potential: it accounts for more than 80 percent of merchandise exports and a large share of manufacturing value added, while generating some logistics, compliance, and certification capabilities with potential spillovers to other industries.[13] Kenya's horticulture sector generates about €1 billion to €1.5 billion in annual exports and supports substantial employment, but evidence of comparable economy-wide spillovers remains limited.[14] Both countries represent important development gains, but the available evidence suggests that Bangladesh has generated broader transformation effects.

Prerequisites and trade-offs

Transformation does not happen in a macroeconomic vacuum. South Korea and Brazil both pursued state-directed industrialization in the 1970s but took very different fiscal paths. South Korea combined export-oriented industrial investment with macroeconomic discipline and performance requirements. In contrast, Brazil relied more heavily on debt-financed public spending and protection without comparable export performance discipline, contributing to macroeconomic instability and industries facing limited competition.[15] Macroeconomic stability creates the conditions for economic transformation, but transformation requires a deliberate and sequenced strategy that channels the policy and fiscal space created by stability into productive investment, capability building, economic diversification, and technological upgrading.[16]

Beyond macroeconomic stability, successful transformers tend to share three common features.

- First, they build institutional capacity to coordinate industrial policy, engage strategically with investors, and enforce performance accountability. This requires competent, well-resourced civil servants and active public-private dialogue, as seen in East Asian economies from the 1960s onward.
- Second, they invest in credible sector diagnostics grounded in reliable data systems. Rwanda's Vision 2020 shows that this is achievable outside East Asia when governments invest in statistical capacity early.[17]
- Third, they secure political settlements that make transformation strategies credible across electoral cycles. Credibility is sustained in one of two ways. The first is domestic support from organized businesses and worker groups that benefit from the transformation strategy. These groups help to defend the strategy through political transitions, as seen with garment exporters in Bangladesh and electronics manufacturers in Vietnam. The second is institutional arrangements that carry strategy beyond any single government. Mauritius sustained its export-led

diversification through repeated coalition turnovers after independence, and Chile's fiscal institutions and export orientation survived the transition from military rule to democracy.

The major constraints vary by country. For lower-middle-income countries, the constraint is moving up global value chains before rising wages reduce the competitiveness of labor-intensive manufacturing. Upper-middle-income countries already have the strategies in place; their constraint is often political. This includes resisting the influence of established firms over industrial policy, as seen in Brazil and Colombia, where policies have been redirected toward protecting these established firms. In low-income countries, the constraint is building institutional infrastructure while managing acute fiscal constraints, which is where well-designed external cooperation has the most to offer. In fragile and conflict-affected countries, the path is longer. Humanitarian assistance is needed, but the persistent gap is the absence of a deliberate transition framework from emergency stabilization to productive sector investment and job creation. Development cooperation in these settings is often most effective when it supports productive sectors as institutional capacity improves, rather than waiting for full stability.

Why this paper?

Despite decades of development cooperation and episodes of rapid growth, many low- and middle-income economies have not achieved sustained transformation. Commodity dependence remains widespread, diversification has been uneven, and vulnerability to external shocks remains high. Much of what cooperation financed was necessary, including stabilization, social services, and institutional capacity. However, successful transformation requires productive upgrading, export diversification, technological progress, and institutional capability. Cooperation was rarely organized to support this in a clear sequence.

Transformation is first a national project. No cooperation modality substitutes for domestic strategy, institutional capability, or sustained political commitment, and every successful transformer discussed in this paper built these at home. Where domestic efforts existed, cooperation either reinforced or undermined the endeavor through its design. The paper therefore addresses both sides of the relationship: what governments must own, and what cooperation must change.

This paper argues that the central challenge for the cooperation system is not only the volume of resources available but also the gap between how cooperation is delivered and what transformation requires. Drawing on evidence from Africa, Asia, and Latin America, the paper examines what development cooperation has and has not achieved, why some countries transformed more successfully than others, and what changes in policy, financing, institutions, and accountability would make transformation a central purpose of development cooperation.

2. The Track Record

Growth without economic transformation

Over the past two decades, economic growth has been broadly shared. Between 2000 and 2015, Central Asia grew by 7.0 percent a year, South Asia by 6.4 percent, Southeast Asia by 6.1 percent and Sub-Saharan Africa by 4.9 percent, with only Latin America lagging at 2.9 percent (Table 1). Economic transformation, however, has not been shared. Manufacturing shares of gross domestic product (GDP) declined in four of the five regions and rose only in Southeast Asia. Nine in 10 Sub-Saharan African economies remained commodity dependent, as did every Central Asian economy and more than half of Latin America. Research shows that, unlike in Asia, labor reallocation in Africa and Latin America often shifted workers from agriculture into relatively low-productivity informal services rather than manufacturing.[18] Other research similarly identifies static gains but dynamic losses in Africa, as employment moved into services where productivity growth lagged behind the global frontier.[19]

The divergence predates the commodity supercycle. Since independence, Africa and Latin America have experienced repeated episodes of rapid growth that failed to produce sustained structural transformation, whereas much of East and Southeast Asia converted successive growth episodes into industrial capability. The boom of 2000 to 2015 and the debt distress that followed repeat this pattern in compressed form. The composition of growth, not its pace, determined what growth delivered in employment, poverty, and resilience across low- and middle-income economies.

Table 1. Uneven structural transformation across regions

Indicator	Sub-Saharan Africa	Latin America & Caribbean	South Asia	Southeast Asia	Central Asia
Economic growth					
Average annual GDP growth *(% 1961–2000)*	2.9	4.0	4.4	5.4	—
Average annual GDP growth *(% 2000–2015)*	4.9	2.9	6.4	6.1	7.0
Economic transformation					
Commodity-dependent economies *(% of countries, 2021–2023)*	90	58	25	27	100

Indicator	Sub-Saharan Africa	Latin America & Caribbean	South Asia	Southeast Asia	Central Asia
Manufacturing value added *(% GDP, 2000 → 2025)*	14 → 10	20 → 17	16 → 14	18 → 20	17 → 13
Change in industry employment *(2000–2024, pp)*	1.8	-1.8	8.4	7.6	5.3
Economic Complexity Index *(2022)*	-0.8	-0.3	0.1	0.4	-0.6
Inclusive outcomes					
Vulnerable employment change *(pp, 2000–2024)*	-2.8	-2.0	-11.0	-14.4	-8.5
Change in poverty headcount ratio $3/day PPP (pp, 2000–2022)	-17.3	-13.8	-41.5	-29.1	-32.1

Sources: Harvard Growth Lab, The Atlas of Economic Complexity, 2024; United Nations Conference on Trade and Development (2025), The State of Commodity Dependence 2025; World Bank, World Development Indicators, 2026.

Note: Southeast Asia refers to the 10-member Association of Southeast Asian Nations, aggregated from country-level data using chained constant-price GDP for growth rows and employment-weighted averages for labor indicators. Central Asia comprises Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan; growth data are shown from 2000 only because of discontinuities in Soviet-era statistics. The Economic Complexity Index measures the diversity and sophistication of a country's export basket relative to the global average; positive values indicate above-average complexity, and negative values indicate below-average complexity. Poverty reduction figures show the percentage point (pp) change in the headcount ratio at $3 a day (2021 purchasing power parity [PPP]).

What development cooperation did and did not do

Development cooperation expanded substantially between 2000 and 2015, and much of what was financed mattered. Macroeconomic stabilization, health, education, and institutional capacity are necessary conditions for transformation, and the same investments underpinned transformation elsewhere. The failure lay in how support was delivered: it was often project based, short cycle, and weakly aligned with national transformation strategies, and rarely sequenced into productive investment and industrial upgrading. The allocation record reflects this delivery model. Between 2020 and 2023, social sectors accounted for 32 percent of bilateral official development assistance (ODA) commitments, while productive sectors received around 12 percent.[20] Stabilization support delivered real gains in fiscal sustainability and macroeconomic

management. However, without a clear pathway into productive sectors, these gains remained exposed to the next external shock. This constraint is not new. The structural adjustment programs of the 1980s and 1990s faced a similar sequencing problem, but on a much larger scale.

Trade liberalization reduced distortions and improved allocative efficiency in several contexts, while fiscal discipline laid the foundations for later reforms. But in several cases, rapid liberalization exposed infant industries to competition before domestic productive capacities could mature, while tight fiscal constraints limited public investment in areas where sustained, long-term commitment was critical to building productive capacity and supporting structural transformation.

Box 1. How successful transformers funded industrialization

South Korea, Vietnam, and Malaysia financed industrial upgrading through combinations of domestic resource mobilization, public coordination, and strategically deployed external finance, with domestic institutions leading and external cooperation playing a supporting role. South Korea's state development finance system channeled resources into priority industries under export performance discipline. In Malaysia, Penang's state-led investment-promotion strategy combined industrial infrastructure, skills development, and investor facilitation to support the emergence of an electronics cluster. Vietnam paired attraction of foreign investment with skills investment and later supplier-development initiatives intended to deepen domestic capabilities and linkages.[21] These cases did not treat concessional finance as a substitute for domestic strategy or capability. Rather, external cooperation was most useful when it supported capability formation, de-risked strategically selected investment, and strengthened domestic institutions.

Where development cooperation has worked

Where transformation has occurred, the common thread has been the alignment of external support with a credible domestic strategy, not the modality or volume of external financing. Box 2 compares four pathways: sector-led in Bangladesh, services exports at scale in India and the Philippines, services-led diversification in Rwanda, and manufacturing-led in Vietnam.

Whether in manufacturing or services, transformation depends on a sector's ability to create benefits for the wider economy. Cooperation is most valuable when it finances productive activity while building institutional capacity for broader upgrading. Sector support alone is not enough. Support works best when linked to production, productivity, and capability objectives rather than delivered in fragmented ways.

Box 2. Four transformation pathways and the role of cooperation

Bangladesh—sector-led.
Strategy: a focused garment strategy combining preferential market access, domestic entrepreneurship, and policy support.
Cooperation: development partners played a complementary role through support to social and human development outcomes, while industrial organization remained largely driven by domestic firms, buyers, and state policy.
Outcome: ready-made garments became the dominant export sector and a major source of manufacturing employment.[22]

India and the Philippines—services exports at scale.
Strategy: information and communication technology (ICT) and business process outsourcing built on domestic skills, private investment, and integration into global services markets.
Cooperation: sector growth was driven principally by domestic policy, private investment, and international demand rather than by concessional finance.
Outcome: services exports generated formal employment and significant foreign exchange earnings. India's technology sector exports reached $199.5 billion in fiscal year 2024, and the sector employed 5.43 million people.[23]

Rwanda, services-led diversification.
Strategy: Vision 2020 prioritized tourism, conference services, ICT, and related knowledge-intensive activities.
Cooperation: external support complemented investment in ICT, tourism, and public sector capability.
Outcome: growth became concentrated in targeted services, while results in special economic zone manufacturing were more mixed.[24]

Vietnam—manufacturing-led.
Strategy: export-oriented manufacturing anchored in foreign direct investment attraction and technical skills.
Cooperation: the Japan International Cooperation Agency, the World Bank, and other development partners supported infrastructure, skills, and institutional investments that complemented export-oriented industrialization.
Outcome: sustained growth in electronics exports and industrial employment, alongside continuing efforts to deepen domestic supplier linkages.[25]

3. What the Evidence Shows: Seven Lessons

Seven lessons emerge from the comparative evidence across Africa, Asia, and Latin America. The first three concern the policy instruments most relevant to transformation. The fourth addresses country ownership and accountability. The remaining ones focus on the development of a cooperation architecture, sequencing, and emerging priorities.

Lesson 1: Transformation requires industrial policy. The question is how to do it well.

Successful transformation has consistently involved deliberate and sustained industrial policy. Across cases as diverse as Chile, Indonesia, Rwanda, South Korea, and Vietnam, transformation depended on state coordination of investment, performance accountability, and strategic sequencing. The question for low- and middle-income countries is not whether to use industrial policy, but how to design and institutionalize it, build political consensus, and sustain implementation.

Box 3. Why architecture failures persist: A political economy frame

The cooperation system's structural bias toward social infrastructure and short-term visible outputs is not irrational from the perspective of individual actors. Donor agency staff are evaluated on disbursement and project completion rates. Parliamentary oversight in donor countries rewards visible humanitarian outcomes over decade-long industrial investments whose returns accrue to citizens in developing countries. Similar incentives shape decision-making in developing countries, where electoral cycles tend to prioritize immediate service delivery over long-term productive investment. The result is a system in which individually rational decisions produce collectively poor outcomes. Reform therefore depends less on advocating for change than on changing the incentive structures under which donor agencies and governments operate.

Industrial policy often fails for specific and correctable reasons, not because state intervention is inherently wrong (Box 3). State support without performance accountability generates rent-seeking. Sector selection without sequencing misallocates resources. Picking winners without exit conditions can sustain losers.[26] Premature deindustrialization, the tendency of low- and middle-income countries to encounter manufacturing decline at far lower income levels than earlier industrializers, implies that the strategic window for labor-intensive manufacturing is narrower than before, making well-designed state coordination more urgent.[27] The implications of AI and technology upgrading are discussed in Lesson 7.

Development partners can contribute directly to the prerequisites: civil servants able to enforce performance conditions, structured public-private dialogue, data infrastructure for credible sector selection, and the digital and physical infrastructure AI adoption requires.

Box 4. Indonesia's nickel processing mandate: industrial policy with trade-offs

Indonesia holds the world's largest nickel reserves, estimated at about 55 million tons, or roughly 42 percent of the global total. Its 2020 ban on unprocessed nickel ore exports accelerated investment in domestic smelting and refining. Between 2019 and 2022, investment in mineral processing and manufacturing rose from $3.56 billion to $10.96 billion, driven largely by Chinese financing. In 2022, a World Trade Organization (WTO) panel found Indonesia's nickel-ore export prohibition and domestic-processing requirement inconsistent with WTO rules. Indonesia appealed, and the dispute remains unresolved because the WTO Appellate Body is not currently functioning.

The model also entails significant trade-offs. Indonesian companies hold less than 10 percent of nickel-mining production, while Chinese firms account for around 40 percent and European firms more than 20 percent. The rapid expansion of midstream capacity has therefore raised questions about foreign ownership, environmental performance, domestic value capture, and the depth of technology transfer. Indonesia's experience illustrates both the potential and the institutional demands of moving from raw mineral exports toward higher-value processing.[28]

Lesson 2: Regional production integration matters more than trade integration for transformation.

For most low- and middle-income economies, the domestic market is too small to support the scale manufacturing requires. Regional integration expands the effective market, but what it delivers depends on the nature and quality of integration. Trade integration removes tariffs and reduces barriers to the movement of goods. Production integration coordinates investment, aligns industrial strategies across borders, harmonizes regulations, and builds shared infrastructure. This coordination generates productive benefits across firms and sectors.

The African Continental Free Trade Area (AfCFTA) and many regional frameworks have been designed primarily around trade integration. The Economic Community of West African States, for instance, illustrates the challenges of implementation. Despite adoption of the West African Common Industrial Policy, limited funding and weak implementation have constrained production integration and industrial outcomes in the region. Trade liberalization alone rarely produces industrialization.[29]

The trajectory of the Association of Southeast Asian Nations (ASEAN) demonstrates the potential of production integration. Intra-ASEAN trade accounted for 21.6 percent of members' total trade in 2023.[30] National specializations, including by Thailand in automotive production, Vietnam in electronics, Malaysia in semiconductors, and Indonesia in nickel processing (Box 4), developed alongside national industrial policies and regional trade and investment arrangements. Regional integration served as a pathway to global markets rather than as an end in itself. Regional production networks gave firms greater scale, experience meeting standards, and supplier relationships that supported entry into global value chains, while extra-regional exports grew alongside intra-regional trade (Box 5).

The AfCFTA, signed by 54 African countries and intended to create a market of more than 1.4 billion people, creates the opportunity for an African equivalent.[31] Realizing this opportunity requires cooperation focused on regional public goods, including cross-border infrastructure, investment coordination, and regulatory harmonization.[32] The test will be whether regional markets build the firm-level capabilities needed for global competitiveness, not simply whether intra-African trade rises. Development cooperation for regional integration should therefore shift from trade facilitation to production integration support, including joint industrial strategies and ODA rules that better accommodate regional investments.

Box 5. Contrasting ASEAN's industrial complementarity with the approach to the Lobito Corridor

ASEAN production networks were supported by national specializations, regional trade and investment arrangements, and sustained investment in connectivity.
The Japan International Cooperation Agency, the Japan Bank for International Cooperation, and targeted programs supported ASEAN connectivity, infrastructure, supply chain resilience, and human resource development. The Lobito Corridor, linking Angola's Atlantic port to the copper and cobalt belts of the Democratic Republic of the Congo and Zambia, has mobilized more than $6 billion in public and private investment. This figure covers interconnected projects across transportation and logistics, agriculture, clean energy, digital access, and related supply chains, rather than fully financed rail construction alone.[33]

However, transportation infrastructure by itself does not produce a production network. Converting the corridor into a value chain requires regulatory harmonization, rules-of-origin alignment, logistics coordination, and industrial policy coordination across the participating countries. These are the coordination challenges where development cooperation can add most value and where significant gaps remain.

Lesson 3: Financing economic transformation requires the right instruments, not just volume.

Today, remittances, private capital, and other external flows often exceed ODA in low- and middle-income countries, yet productive sectors remain underfunded. The central financing challenge is not only the volume of resources, but also their allocation, instruments, and time horizons.[34] The question is not simply how to scale ODA, but how to align the wider financing landscape with transformation objectives.

Domestic resource mobilization is the first-order priority. The United Nations Conference on Trade and Development estimates that Africa lost an average of $88.6 billion annually through illicit financial flows during 2013–2015. This amount exceeded the annual ODA to the continent over the same period.[35]

Among external financing flows, development finance and blended finance instruments can support transformation. However, blended finance has focused on middle-income markets and commercially viable sectors such as energy, infrastructure, and financial services, rather than on the greenfield productive investments and lower-income settings where transformation needs are often greatest.[36]

Sovereign borrowing costs present a separate but equally important financing challenge. Developing countries paid, on average, around 200 basis points more for international capital than developed countries between 2012 and 2023, with the difference much larger in Africa. The United Nations Development Programme estimates that subjectivity in sovereign credit rating assessments costs African countries up to $74.5 billion through higher borrowing costs and forgone lending. High debt service burdens reduce fiscal space for productive investment, while foreign currency borrowing exposes governments to exchange rate risk.[37] The Africa Credit Ratings Initiative and the recently launched Borrowers Platform represent practical near-term reforms.

The instrument mix in Table 2 is stage dependent, not universal. Low-income countries, where institutional infrastructure is still developing, draw most value from concessional finance and grants directed at capabilities and early productive investment. Blended instruments become more useful as absorptive capacity develops. Middle-income countries that need to upgrade their value chain need equity from development finance institutions (DFIs), risk instruments, and patient capital more than they need concessional finance. Financing strategies succeed when matched to the binding constraints previously discussed in Section 1, which differ by income level and institutional context.

Table 2. Development finance for transformation: From legacy to reimagined

Dimension	Legacy / ODA-Dominated	Reimagined / Pluralized
Primary source	Bilateral ODA + multilateral development bank sovereign loans	Domestic resource mobilization, multilateral development banks, DFIs, blended finance, South-South cooperation, diaspora investment + ODA

Dimension	Legacy / ODA-Dominated	Reimagined / Pluralized
Instruments	Grants, concessional loans, technical assistance	Guarantees, special purpose vehicles, bonds, equity, risk capital
Time horizon	3–5 year project cycles	10–20 year transformation compacts
Sector orientation	Social sectors 32 percent of ODA; productive 12 percent	Aligned with country transformation priorities; productive and social investment co-determined by national strategy
Accountability	To donor outputs and audit	To structural change indicators and citizens, alongside provider accountability for results
Regional scope	Bilateral; cannot finance cross-border	Regional platforms; rewards integration

Source: Authors' framework.

Lesson 4: Country ownership and accountability to domestic citizens are prerequisites for economic transformation.

Economic transformation is more likely to succeed when governments are accountable to domestic citizens and constituencies, rather than principally to external actors.[38] That accountability can be weakened from two directions. First, donor dependence can shift government attention toward external reporting requirements rather than domestic constituencies and long-term transformation priorities. Second, extractive capture can operate both externally, through resource-backed finance that prioritizes foreign investor returns over domestic capability building, and internally, through elite capture of resource revenues and investment benefits. As Box 7 in the next section illustrates, resource-backed arrangements can constrain fiscal space precisely when productive investment is most needed.

Cooperation instruments can help address both risks: supporting governments to negotiate technology transfer, domestic content requirements, and investment terms that serve transformation, while strengthening parliamentary oversight, civil society engagement, and transparent public finance management.

The evidence on ownership is visible in the longer arc of successful transformers. In early phases, external cooperation can add value through sector diagnostics, civil service capability, public-private dialogue, and data systems. South Korea used early external assistance to support domestic capacity building, reduced reliance as transformation progressed, and later became a provider of development cooperation and policy advice.[39] The Korea Development Institute and Ministry of Economy and Finance have implemented the Knowledge Sharing Program since 2004, providing policy consultation and sharing South Korea's development experience with partner countries.[40]

This paper therefore proposes a shift from a charity mindset to one of mutual investment: framing development cooperation investments as contributions to a more stable, productive, and less unequal world economy, rather than as transfers from generous donors to grateful recipients.

Lesson 5: Economic transformation requires long-term development cooperation.

Transformation rarely fits within three- to five-year project cycles, yet much development cooperation remains organized around such horizons. Programming cycles, political pressure for visible results within electoral periods, and attribution frameworks create incentives to finance what can be completed and measured quickly. The result is a focus on interventions that generate quick, measurable results rather than investments whose transformational impacts take decades to emerge.
As illustrated by Box 3 under Lesson 1, these incentives are individually rational yet collectively misaligned with the long-term nature of economic transformation. Addressing this requires changes to the architecture of cooperation.

Lesson 6: Sequencing matters for cooperation success.

Sequencing determines whether cooperation instruments support or undermine a country's stage of productive development. Trade liberalization before productive capacity exists can expose infant industries to competition before they have acquired the capabilities to compete. Privatization before regulatory institutions are established can transfer rents without creating competitive markets. Cutting expenditure or spending without a plan to sustain productive investment can remove the resources needed for transformation. Vietnam and Bangladesh illustrate alternative approaches. Vietnam liberalized trade and investment gradually after the Doi Moi reforms, while Bangladesh combined preferential market access with trade facilitation and export support measures that enabled garment firms to grow.[41]

The sequencing lesson applies to domestic policy as much as to cooperation instruments. Countries that stabilized without an industrial strategy, or liberalized before productive capacity existed, risked reproducing the same failure regardless of whether conditionality drove the decision. Both governments and their cooperation partners should therefore assess whether the instruments being deployed match the country's productive development stage, as the Pakistan and Sri Lanka cases in Box 6 illustrate.

Box 6. Pakistan and Sri Lanka: When stabilization replaces transformation

Since 1958, Pakistan has entered repeated programs supported by the International Monetary Fund (IMF), reflecting persistent external financing and fiscal pressures. Manufacturing value added fell from about 15.7 percent of GDP in 1994 to 13.6 percent in 2023. The IMF-supported program approved in 2024 included energy-price reforms,

expenditure restraint, and measures to improve the viability of the power and gas sectors. These measures were necessary for macroeconomic stabilization, but they underline the importance of linking adjustment to a credible pathway for productive investment, export upgrading, and formal employment.[42]

Sri Lanka reached upper-middle-income status in 2019, but its structural vulnerabilities remained acute. The COVID-19 pandemic reduced tourism receipts—from 4.3 percent of GDP in 2019 to 0.8 percent in 2020—while weak fiscal buffers, risky commercial borrowing, and external financing pressures intensified the crisis. The 2022 sovereign default reflected these fiscal and external vulnerabilities, compounded by the pandemic and other shocks.[43] The lesson in both cases is the same: stabilization programs should specify a sequenced pathway from fiscal consolidation to productive sector investment, rather than assuming this transition will happen on its own.

Lesson 7: The green transition, youth employment, SME financing, and technology adoption are transformation imperatives, not separate tracks.

Green industrialization, youth employment, SME financing, and technology upgrading are four key areas that are often treated separately but face the same underlying challenges, including too few productive sectors that can create jobs, generate revenue, and build capabilities. Aligning these four key areas within a broader transformation strategy can produce stronger results than treating them as separate agendas.

The green transition is a manufacturing and growth opportunity as much as a climate priority. Countries that capture this opportunity will treat green industrialization as an industrial policy challenge rather than only an energy access problem. Renewable energy programs across Africa, Latin America, and South Asia have often relied heavily on imported equipment. Morocco's Noor solar complex illustrates an alternative approach. Its project design included local content and capability-building objectives, creating opportunities for Moroccan participation in construction, engineering, installation, and maintenance.[44]

Youth exclusion from decent work is not only a skills problem but also a productive sector problem. In 2023, the rate of young people not in education, employment or training was 26.4 percent in South Asia, 20.4 percent in Sub-Saharan Africa, and 19.7 percent in Latin America and the Caribbean.[45] Economies that have not built manufacturing and tradable services capable of absorbing young workers into formal employment cannot solve youth exclusion through training programs alone.

SME finance can support transformation when it is linked to sector development strategies, supplier development, standards, buyer linkages, and skills. Standalone credit lines can improve access to finance but do not, by themselves, connect SMEs to the value chains and market relationships needed for productive upgrading. Ethiopia's leather and footwear initiatives combined access to finance with enterprise networks, technology upgrading, skills development, and efforts to build both backward and forward linkages.[46]

East and Southeast Asia's transformation relied heavily on technology absorption rather than frontier invention. South Korea selectively restricted inward foreign direct investment while using licensing and reverse engineering to build domestic capability. Taiwan's Industrial Technology Research Institute acquired foreign semiconductor technology, adapted it, and helped build firms such as the Taiwan Semiconductor Manufacturing Company. In Penang, multinational investment was paired with efforts to strengthen local sourcing, skills, and supplier capabilities.[47]

AI is the current frontier of the same absorption challenge. Low- and middle-income countries need not compete at the technology frontier. What matters is whether institutions can absorb and deploy existing AI applications across manufacturing, agro-processing, and services. Reliable electricity, broadband connectivity, technical skills, data capacity, and institutional capability are more immediately binding constraints than frontier model development.[48]

4. Recommendations for Transformation-Focused Development Cooperation

Drawing on these seven lessons, the following recommendations are offered for governments of low- and middle-income countries and for development cooperation partners.

What low- and middle-income countries must do

These recommendations address five areas of national action where the evidence shows the clearest need. These areas are closely connected and should be addressed together. Better financing terms, for example, achieve little without accountability for how funds are used. Regional ambitions likewise require coherent national policies.

1. **Build institutional capability to implement economic transformation strategies.** In many countries, the constraint is not the absence of strategy but limited implementation capability and weak mechanisms for public-private coordination and accountability. Governments should establish sector-specific coordination mechanisms that identify sector constraints and establish accountability for results, modeled on Peru's Mesas Ejecutivas or South Korea's export performance conditionality system.[49] They should also invest in the statistical capacity that makes credible sector diagnostics possible.
2. **Negotiate finance that supports domestic value addition and industrial upgrading.** Debt architectures that crowd out productive investment undermine transformation strategies before they take hold. The shift toward commercial and non-Paris Club lenders has created debt structures that constrain policy space precisely when productive investment is most needed.[50] As Box 7 illustrates, the terms of resource-backed finance are negotiable when governments approach them with strategic clarity. The difference lies in negotiating capacity and political commitment.
3. **Align regional and national transformation agendas.** The AfCFTA and other regional frameworks will deliver transformation only if member states align national trade and industrial policy with regional commitments rather than treating them as parallel tracks. The binding constraint on regional integration is not the absence of agreements but the absence of domestic policy coherence—systems for implementing rules of origin that are not in use, customs procedures that are not harmonized, and industrial strategies that remain nationally siloed.[51] Low- and middle-income countries, particularly in Africa, must develop joint industrial strategies at the regional level and build the institutional capacity to implement regional commitments.
4. **Build domestic accountability and political consensus around a long-term transformation compact**. Governments should use transparent sector performance reporting, parliamentary oversight of industrial policy, and clear public communication of transformation goals. These measures can make policy reversal more difficult and help sustain economic transformation across electoral cycles.

5. **Strengthen national agency in development cooperation.** Governments should lead rather than simply react to changes in the evolving external financing landscape. The starting point should be national cooperation frameworks that clearly define how external finance, technical assistance, and investment contribute to transformation goals. These frameworks should be backed by the capacity to negotiate, coordinate, and monitor complex partnerships.

Box 7. Resource-backed finance: Lessons from Angola

Angola's resource-backed borrowing illustrates the fiscal risks of relying on commodity collateral without sufficient safeguards for domestic value addition and fiscal resilience. Following the 2014 oil price shock, debt vulnerabilities rose sharply. In its 2019 program review, the IMF projected that total debt service would peak at about 100 percent of fiscal revenues in 2020. Infrastructure-for-oil arrangements also raised concerns about the limited participation of domestic firms and the depth of technology transfer. Similar risks can arise where resource-backed finance prioritizes creditor repayment and external contracting over domestic capability building. Governments should negotiate resource partnerships as instruments of industrial policy rather than as sources of fiscal revenue alone.[52]

What development partners must do

The cooperation system already possesses the instruments, mandates, and demonstrated models to support countries' transformation. What has been missing is the political will to prioritize structural transformation over short-cycle visibility and the accountability frameworks needed to reinforce that shift. Six recommendations follow. (Box 8 sequences them by time horizon.)

1. **Move from projects to programs.** The most urgent shift for bilateral donors and multilateral development banks is to move from project-based to program-based financing, which will provide partner governments with strategic flexibility. The Millennium Challenge Corporation compact model, European Union budget support, and the World Bank's Program-for-Results each demonstrate feasibility at scale.[53]
2. **Finance regional production systems.** Cooperation must shift from trade facilitation to production integration, financing for cross-border infrastructure, investment coordination, joint industrial strategies, and ODA allocation to regional investments.
3. **Deploy finance predictably and at transformation timescales.** Structural transformation takes time, often about 10 to 20 years, and financing must reflect this. Climate finance provides a cautionary example: the $100 billion commitment was first met in 2022, two years after the original 2020 target.[54] Critics have also argued that a substantial share was counted from existing

development finance flows and fragmented across multiple funds, reducing its planning value for partner governments.[55] Addressing this requires multi-decade partnerships with committed governments, tying funding disbursements directly to shared, measurable milestones.

4. **Make technology transfer and capability building standard features of development finance.** Development finance providers should incorporate clear provisions for domestic capability building, supplier development, skills transfer, and, where appropriate, technology transfer into concessional, blended, and DFI-supported investments.
5. **Agree on mutual accountability with partners, not *for* them.** Frameworks must track transformation outcomes such as manufacturing share, export complexity, and formal employment growth, rather than output-oriented disbursement rates and completion metrics. Greater attention should also be paid to how these frameworks are set. Indicators must be negotiated jointly with partner governments and their regional institutions, with obligations running in both directions. When this happens, both sides are accountable to the public. Donors answer for predictability and alignment, while partner governments answer for results based on their own strategies.
6. **Create room at the table.** The terms of cooperation are often set in places where low- and middle-income countries have limited influence, such as international financial institution boards, credit rating systems, and bodies that set rules for trade, investment, and finance. Reform requires fairer voting shares and board representation in institutions that govern development finance. It also requires giving greater weight to collective platforms—such as the African Union, the Community of Latin American and Caribbean States, and the Group of 77, among others—when setting cooperation priorities and financing conditions.

Box 8. Sequencing the recommendations for development partners

Near term (1 to 3 years): pilot program budgets in willing countries (projects to programs), DFI and blended finance screening reoriented toward greenfield productive investment (technology transfer), reform of ODA attribution for regional investments (regional production systems).

Medium term (3 to 7 years): multi-decade transformation compacts (transformation timescales), African credit-rating reform and borrower country coordination on rating methodologies (room at the table), IMF conditionality incorporating transformation sequencing (mutual accountability), regional industrial complementarity frameworks under AfCFTA (regional production systems).

Long term (7+ years): trade architecture reform protecting industrial policy space, multilateral accountability for transformation outcomes (mutual accountability). Several near-term actions could be pursued within existing mandates. Starting there builds precedent for the rest.

5. Conclusion

Bangladesh, Chile, Mauritius, Morocco, Rwanda, South Korea, and Vietnam demonstrate that economic transformation can be rapid, deep, and durable when domestic strategy, institutional capacity, and external support align around the same objective. These experiences were not exceptional. They reflect country-led strategies supported by cooperation systems aligned with national priorities rather than donor-driven agendas.

Growth without economic transformation leaves economies exposed to the same external conditions that drove the expansion. The 2014 commodity price reversal made these vulnerabilities visible across the commodity-dependent regions simultaneously. The recent contraction in development assistance is making them visible again. The institutional barriers in the cooperation architecture are specific and clear. They include short programming cycles, conditionality applied without sequencing, bilateral fragmentation that cannot fund cross-border production integration, and financing concentrated in social sectors and extractive industries rather than productive investment.

The seven lessons developed in this paper point to a coherent reform agenda, much of which is achievable within existing institutional mandates. The paper proposes a different way to judge one purpose of cooperation: not by the amount of finance mobilized or the number of projects completed, but by the contribution to sustained transformation.

The evidence from this paper shows that the cooperation system has the tools, instruments, and knowledge needed to support transformation. What has been missing is the political will to make transformation a central goal. That is a choice, and it remains possible. A cooperation system built around this goal can contribute to a richer, more stable, and more capable world.

Endnotes

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[2] This definition combines the African Center for Economic Transformation's Growth with DEPTH framework with the structural-change literature's emphasis on reallocation and within-sector upgrading.

[3] Structural transformation is a necessary, but not sufficient, condition for economic transformation. The two terms are related but not interchangeable.

[4] This paper uses "development cooperation" to refer to the full range of external public support instruments, including bilateral official development assistance, multilateral concessional lending, development finance institution lending and guarantees, blended finance facilities, and South-South cooperation.

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