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Global crises and the commodity dependence of the least developed countries:

Impacts, challenges and the way forward

Executive Summary

At a time when the international community is voicing an ever greater concern over rising and more volatile commodity prices, the strong commodity dependence of the least developed countries (LDCs) is, yet again, brought to the fore as a burning issue. It is, therefore, highly pertinent to analyse the commodity dependence of LDCs in view of the recent global crises. In this context, this note explores the following key questions:

- *What were the linkages between the multiple global crises and the commodity dependence of LDCs?*
- *How did commodity price volatility undermine the growth potential in LDCs, including their food security?*
- *What policy responses and specific actions are required to tackle the development challenges concerning the commodity dependence of LDCs?*

The note puts forward some answers to these questions by drawing on case studies of five LDCs in Africa and Asia, as well as by referring to available literature. It is argued that LDCs need to clearly articulate how to link the commodity sector to their national development strategies.

UNCTAD/ALDC/MISC/2011/6

1. Introduction

The global and economic crisis…the fuel crisis…food price spikes and increased commodity price volatility… climate change…

The world finds itself at a point where it is reeling from the aftershocks of recent global crises and is confronting immense challenges that call for immediate action. One of the most pressing challenges is how to improve sustainably the lives of people in the most vulnerable and hardest-hit countries in the world: LDCs. As of 2011, this group comprises 48 countries with an estimated population of 855 million people. The average gross domestic product (GDP) per capita of LDCs in 2009 was $614, compared with a world average of $7,462.

Inextricably linked to the development challenges of LDCs is the role of commodities. Just consider the following illustrative facts of the extent of the LDCs' dependence on commodities:[1]

- Almost two thirds of the labour force in LDCs are employed in the agricultural sector;
- The share of agriculture in LDCs' GDP over the years 2006–2008 stood at 27 per cent, compared with 4 per cent in the world's gross output and 9 per cent in developing countries' GDP;
- LDCs constitute 44 of the 70 countries that are classified as low-income food-deficit countries (LIFDCs) by the Food and Agriculture Organization of the United Nations (FAO) in 2011;
- In March 2011, 20 LDCs were considered as requiring external assistance for food by FAO, out of a total 29 countries;[2]
- According to UNCTAD classification, 27 LDCs are commodity exporters.[3] Moreover, the three largest exports in 19 of these 27 countries were commodity products that accounted for more than 50 per cent of merchandise exports in 2009;
- Commodities accounted for four fifths of LDCs' goods exports during 2007–2009, with the share of commodities exceeding 50 per cent in 38 countries.

The logical corollary of the commodity dependence is that natural resources play a crucial role in LDCs' economic growth, poverty reduction and food security.[4] This significant role of commodities is also reflected in the UNCTAD proposal for a new international development architecture, which highlights commodities as one of five key pillars in a forward-looking agenda to shape international economic relations.[5]

The triple-F crises – fuel, food and financial – exacerbated the vulnerability of LDCs and recalled the group's over-reliance on the export of a few primary commodities

[1] Unless otherwise specified, the data come from UNCTADstat.
[2] FAO, 2011a., which provides the following definition: "Countries requiring external assistance for food are expected to lack the resources to deal with reported critical problems of food insecurity."
[3] Eleven agricultural exporters, 10 mineral exporters and 6 oil exporters. UNCTAD, 2010a, p. XV.
[4] See, for instance, UNCTAD, 2002, chapter 4, for a discussion on commodity export dependence and the international poverty trap.
[5] UNCTAD, 2010a.

and on the vagaries of commodity prices. In order to examine the impacts of these external shocks on LDCs from the perspective of commodities, UNCTAD has commissioned case studies that take a closer look at how the commodity sectors in five countries[6] have been affected by the recent global crises. This issue note draws on these case studies, as well as on other sources, to review the linkages between the crises and commodity dependence in LDCs, with particular attention paid to the issues of commodity price volatility and food security. It also discusses common challenges that LDCs face and highlights policy measures that some of them have taken to address these challenges. Based on this bottom-up approach, the issue note concludes with lessons learned and policy recommendations for the decade ahead.

2. Commodity dependence and the global crises

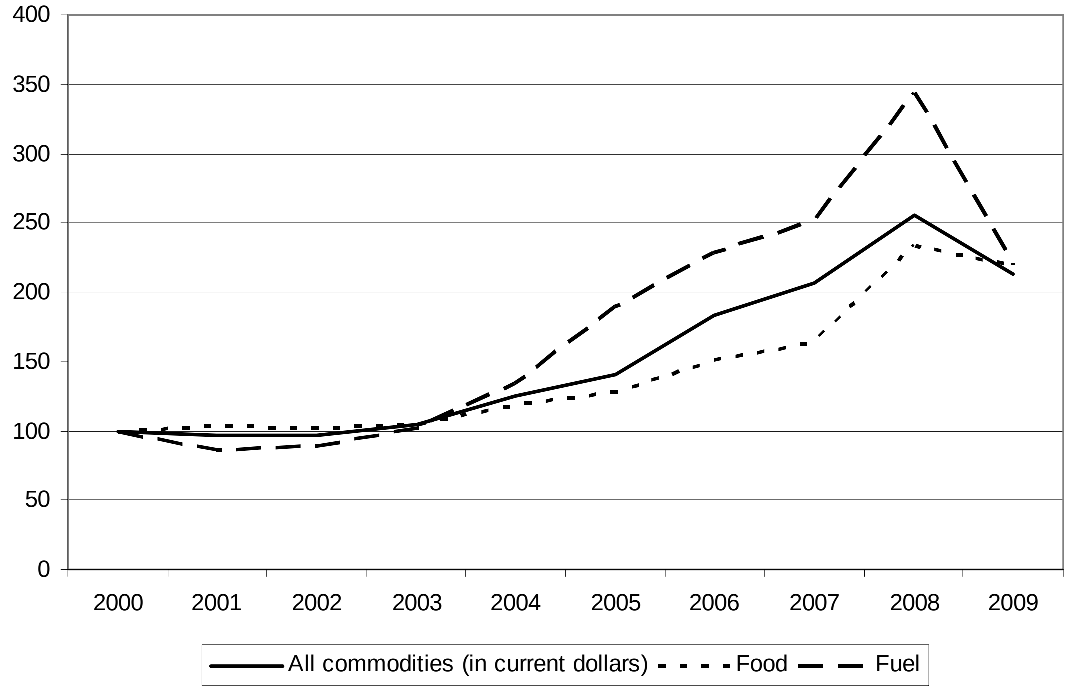
Commodity price volatility and food security are at the top of the international agenda, with France including the issues among the key priorities of its G20 presidency in 2011. This is hardly surprising, considering how energy and food prices have fluctuated in recent years and the negative impact these movements have had on people's access to food.

The general story of commodity prices in the past decade is well known and is depicted in figure 1. An upward trend in prices began a few years into the new millennium and reached a climax in mid-2008. Then, as the effects of the financial and economic crisis spread around the globe, commodity prices tumbled dramatically, although the overall levels in 2009 remained higher than those of 2005 (in current United States dollars). Since 2009, prices have started to climb again. In fact, the prices of the main commodity groups in early 2011 were at or above their levels of January 2008.

[6] Benin, Burundi, Cambodia, the United Republic of Tanzania and Zambia.

Figure 1. Evolution of annual commodity price indices, 2000–2009

(2000 = 100)



Source: UNCTADstat.

The broader implications of these trends on the economies of LDCs have been explored elsewhere.[7] In short, rising commodity prices were a major factor behind real GDP in LDCs growing in excess of 7 per cent per annum during 2002–2007. This boom period came to an end with the outbreak of the global financial and economic crisis. As a result, real GDP growth in LDCs slowed to below 5 per cent in 2009.

As always, such aggregate figures mask a range of varied performances. During 2002–2007, for instance, real GDP per capita surged by more than 6 per cent in 7 LDCs, whereas it contracted in 11 countries. As would be expected, there were several fuel and mineral exporters among the economies that enjoyed the fastest growth. As for 2009, 15 LDCs experienced negative growth in real GDP per capita, while only 2 countries grew in excess of 6 per cent in per capita terms that year.[8]

Bearing these general trends in mind, the rest of this section looks at the global crises in the context of two particular aspects of commodities: commodity price volatility and food security.

2.1. The ups and downs of commodity prices

The plunge in commodity prices in 2009 was the most dramatic drop in a decade. However, as can be seen in figure 2, it was by no means the only time that prices

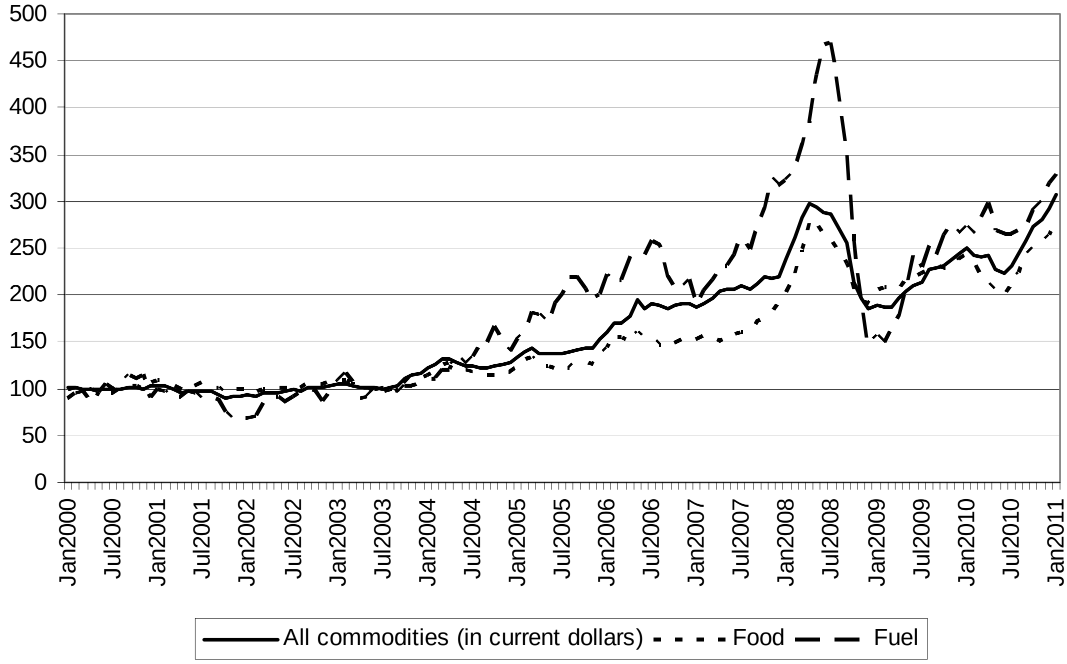
[7] See, for instance, UNCTAD, 2010a and UNCTAD, 2010b.

[8] But for the last sentence, all GDP growth data are taken from UNCTAD, 2010a. The last sentence is based on estimated data from UNCTAD*stat*.

experienced swings. The figure also suggests that these fluctuations increased as the decade wore on. In other words, in tandem with a general increase in commodity prices in the 2000s, there appear to have been an overall rise in price volatility.

Figure 2. Evolution of monthly commodity price indices, January 2000–January 2011

(2000 = 100)



Source: UNCTADstat.

It is important, however, to qualify the statement that there was "an overall rise in price volatility" with two caveats. First, the generality of the statement obscures the varied evolution of different commodities. Figure 2 hints at these differences by showing, in addition to the average price trend for all commodities, the development of food and fuel prices. More analytically, a study on food price volatility found that the price variability of most foodstuffs, including soya bean oil and groundnut oil, increased during 2007–2009 compared with before, but that there also were several instances to the contrary (e.g. the price volatility of bananas dropped during the same period).[9]

Figure 3 illustrates the differences among product categories further by looking at how price instability indices changed over the past three decades. It shows that, on average, commodity prices fluctuated more in the 2000s than in the 1990s. At a more disaggregate level, however, price volatility rose for three of the five commodity groups (food, vegetable oilseeds and oils, and minerals, ores and metals), while the opposite trend was seen for tropical beverages and agricultural raw materials.

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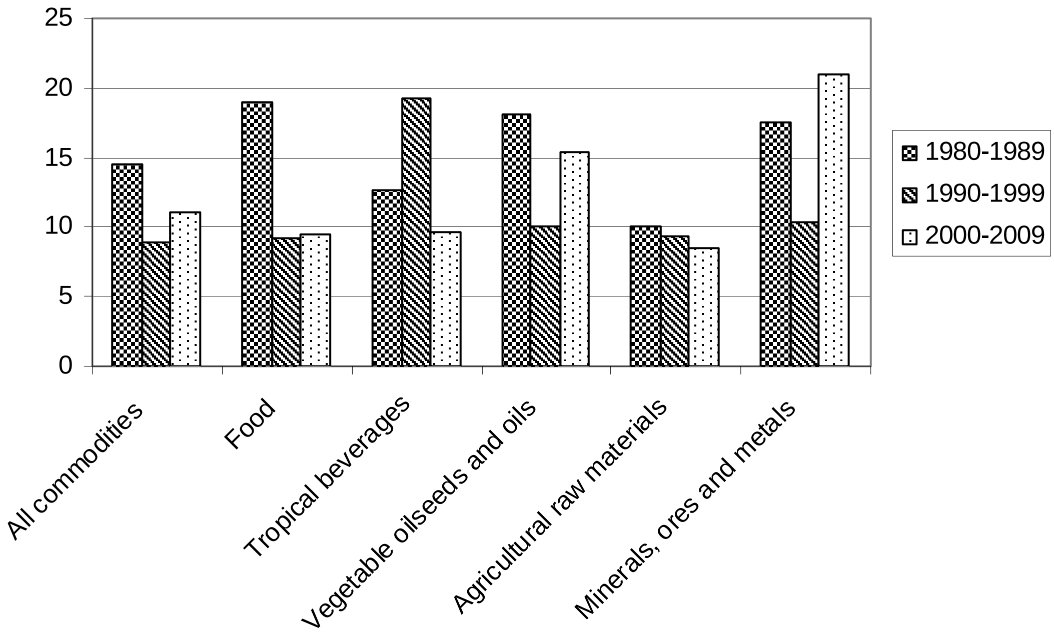
[9] Gilbert and Morgan, 2010. For another preliminary study analysing the evolution of commodity price volatility, see Mayer and Gareis, 2010.

Figure 3. Price instability indices for various commodity groups in 1980–1989, 1990–1999 and 2000–2009



Note: The greater the variability, the higher the index. Instability is measured as the percentage deviation of the variables concerned from their exponential trend levels for a given period.
Source: UNCTADstat.

The price instability indices depicted in figure 3 also relate to the second caveat: the importance of bearing in mind what periods are being compared. Thus, whereas the price volatility for all commodities on average was higher in 2000–2009 than in the preceding decade, it was lower than in the 1980s. In fact, the only commodity group that exhibited a higher variability in the latter period was minerals, ores and metals. Similarly, UNCTAD (2008b) shows that commodity price volatility was generally higher in the 2002–2007 period than in the 1996–2001 period. Comparing even longer periods, Gilbert and Morgan (2010) find that the variability in agricultural prices was generally lower between 1990 and 2009 than in the 1970–1989 period, with bananas and rice being the two main exceptions.

2.1.1. Causes of price volatility

A distinct characteristic shared by many commodities is a low elasticity of demand in the short term, that is, that changes in the supply or demand of commodities give rise to even greater changes in their prices. This explains in part why prices of commodities have a general tendency to fluctuate more than manufactures. As for the general increase in commodity price volatility seen in the past decade, a range of factors have been highlighted as possible reasons. In terms of supply- and demand-side factors, the following factors have been put forward:[10]

- Supply-side factors:
    - Low investment in agriculture over several decades and low investment in the oil and mineral sectors in the 1990s;
    - Good or poor harvests stemming from favourable or adverse weather conditions, for example, in Argentina, Australia and Russia;
    - Decreasing inventory levels – partly as a result of just-in-time management – which lowered the ability to respond to demand shocks;
    - Greater cost and difficulty in finding and accessing new supplies of exhaustible natural resources;
    - Increasing competition from new entrants on the international commodity markets.
- Demand-side factors:
    - Growing appetite for commodities from fast-growing developing countries, particularly emerging Asian economies;
    - Growing demand for biofuels as an alternative to oil, which has shifted arable land away from food crops;
    - A rise in futures speculation in commodities, with index-based investors, in particular, spurring further demand through long positions.

Other factors that also affect commodity prices and their volatility include higher freight rates; geopolitical tensions, especially in the case of oil; and exchange rate variability – more specifically, the depreciation or appreciation of the dollar. Moreover, the correlation among commodities has been highlighted as a cause for the higher price volatility, with oil prices in particular influencing other commodity prices.

Cumulatively, the above-mentioned factors led to growing demand, coupled with sluggish supply, for much of the 2000s. The result was rising commodity prices that culminated in the fuel and food crises of 2007–08. However, the combination of the factors also triggered increased price volatility: the most notorious episode occurring in 2008 when, in the wake of the global financial and economic crisis, the price spike reversed and commodity prices went into freefall.

2.1.2. Commodity price volatility and the global crises

It is straightforward to see that a change in the level of commodity prices can have a significant impact on LDCs. For instance, whereas the rise in commodity prices until mid-2008 benefited several mineral and fuel exporters because of improved terms of trade, the increase in food prices hurt net food-importing developing countries (see the next section for a more detailed analysis on food security). In addition to the impact of a rise or fall in prices, however, wild swings in commodity prices pose, in themselves,

[10] The following discussion on causes of commodity price volatility draws primarily on Gilbert and Morgan, 2010, and UNCTAD, 2008b.

particular challenges for LDCs. These challenges can be thought of as reflecting two interrelated issues: stability and uncertainty.[11]

With regard to stability, volatile prices negatively affect the ability of commodity-dependent countries to maintain steady income and spending. This can, in turn, have dire consequences for governments' capacity to keep current account balances stable, to finance domestic and external debt, and to provide social spending aimed at poverty reduction, among others. The recent global crises indicate the extent to which this capacity can be compromised. For instance, the case study on the United Republic of Tanzania reports that the fiscal deficit widened from 3.1 per cent in 2008 to 6.6 per cent in 2009. Meanwhile, up to 22 per cent of government revenue was lost in Zambia between 2009 and 2010, which led to a sharp decline in actual expenditures and forced the Government to review spending priorities for some social and development projects.[12]

More broadly, the fuel and food crises contributed to a worsening of the current account deficits of oil-importing and food-importing LDCs, but the drop in commodity prices that followed in the wake of the global financial and economic crisis led to an improvement in their current account balances. Conversely, oil exporters were hard hit by the plunge in commodity prices: the current account surplus of $2.6 billion that they had enjoyed in 2008 was transformed into a whopping $14.8 billion current account deficit in 2009. Analysis confirms that these trends were first and foremost attributed to changes in the values of trade goods rather than in their volumes.[13]

As for uncertainty, fluctuating prices make it more difficult for stakeholders to plan for investments and production, which increases costs both at the macro- and micro-levels, for example, through perceptions of higher country risk or access to and cost of finance.[14] A couple of examples can be drawn from the case studies, with the analyses on Burundi and the United Republic of Tanzania alluding to difficulties to raise credit for investment in and marketing of traditional export crops.

In the final analysis, commodity price volatility constitutes an important challenge for LDCs in that its negative effects – lower investment or sudden movements in real exchange rates, to add a couple of other examples to those already mentioned[15] – hamper economic development and poverty reduction. Thus, although a multitude of interrelated factors make it difficult to disentangle the precise linkages between commodity price volatility and the global crises, it is clear that the wild price swings that went with the latter had a devastating impact on LDCs. Perhaps was this nowhere starker than in the area of food security, as is discussed next.

2.2. The impact of the global crises on food security

[11] See also the analysis in UNCTAD, 2002.
[12] Ndlovu, 2011b, pp. 25–30.
[13] See WTO, 2011.
[14] UNCTAD, 2008b.
[15] See, for example, Gilbert and Morgan, 2010; Mayer and Gareis, 2010; and UNCTAD, 2008b for more detailed discussions on the negative impacts of commodity price volatility.

One of the direst consequences of price fluctuations in commodities is on food security in LDCs, especially since poor households spend a large share of their incomes on food – up to 80 per cent in some cases. This was borne out in particularly disturbing fashion during the food crisis in 2007–08, which raised global undernourishment by an estimated 6.8 per cent and pushed at least 100 million people into poverty.[16] The crisis has also been labelled as one of the chief causes of food riots taking place in eight LDCs between 2007 and the first half of 2008.[17] More recently, it has been estimated that 44 million people in low- and middle-income countries have fallen into poverty since food prices started to climb in mid-2010.[18]

The overall increase in food prices during the previous decade (see figures 1 and 2) led to a concomitant rise in LDCs' food import bills: from more than $9 billion in 2002 to $24 billion in 2008[19], although this dropped somewhat in 2009. However, even net exporters of agricultural products could not benefit from the higher prices, as prices of inputs, such as oils and phosphates, rose even faster. For instance, one study estimates that taking into account all commodity price changes can imply a 6 per cent negative shock on the GDP of the United Republic of Tanzania.[20]

At the household level, as discussed in UNCTAD (2008a), it seems logical that the urban population was more acutely affected by the food crisis than people in rural areas, since the latter group's food consumption is partly based on its own production. That said, a majority of the rural population in LDCs appears to consist of net food buyers. Estimates from FAO, for instance, suggest that 72 per cent of rural households in Bangladesh were net buyers of staple foods in 2000.[21] Moreover, even for net food sellers, the inflationary pressures arising from higher fuel, food and fertilizer prices posed a heavy burden.

Households' food consumption also suffered because of job losses that resulted from the global financial and economic crisis. For instance, one study on the impact in the United Republic of Tanzania estimates that employment in agricultural estates, mining and tourism fell by 27 per cent between 2008 and 2009, while another study found that the mining labour force in Zambia was reduced by 30.4 per cent between June 2008 and June 2009.[22] Similarly, household surveys in rural and urban Cambodia report that 9 per cent of poor households had experienced job losses in 2009. Since this was higher than the national average, it suggests that the poorest groups in the society were more adversely affected by the crisis.[23]

[16] Tiwari and Zaman, 2010.
[17] UNCTAD, 2008a, p. 83.
[18] World Bank, 2011a.
[19] UNCTAD, 2010a.
[20] Conforti and Sarris, 2008, referred to in Lines, 2011, p. 11. The United Republic of Tanzania is classified as an LIFDC by FAO, but the country was a net exporter of food and beverages throughout the 2000s.
[21] FAO, 2008, p. 22. The figures for all households and all poor households were 76.8 per cent and 84.2 per cent, respectively, while they were 95.9 per cent and 95.5 per cent, respectively, for urban households and poor urban households.
[22] United Republic of Tanzania: Muro, 2010; Zambia: Matenga, 2010. Both studies are cited in Ndlovu, 2011b.
[23] Runsinarith, 2011.

The household surveys in Cambodia are revealing in that they shed light on the impact of the recent global crises at the micro-level. For instance, it was found that the share of households that did not have sufficient money for food and other essential expenses increased from 62 per cent to 69 per cent between June 2007 and June 2008. As another example, the pattern of consumption evolved differently during the peak of the food crisis, compared with that which developed during the peak of the global financial crisis. Thus, 92 per cent of the households said that their expenditure on food had increased in the six months leading up to June 2008 and 48 per cent reported that their expenditure on non-food items had risen during the same period (51 per cent reported no change). However, the share of the households that said that their expenditure on food had increased during the period March–July 2009 stood at 27 per cent (31 per cent reported no change and 42 per cent reported a decrease), while 15 per cent found that their non-food spending had risen during the same period (41 per cent reported no change and 44 per cent said that this expenditure had declined).

3. Coping with commodity dependence

The global crises have exacerbated the vulnerability of LDCs and recalled the risks associated with relying on a few primary commodities. The previous section pointed to some of the adverse effects of the crises on LDCs in the context of commodity price volatility and food security. What, then, are the particular challenges that need to be addressed and what are the possible solutions?

At a basic level, countries can tackle the challenges related to commodity dependence by improving their management of natural resources and/or by diversifying their production and exports. Thus, in approaching the dual question of challenges and solutions, this section is divided into two main parts. The first part looks at the commodities sectors themselves in order to evaluate ways in which the use of these resources can be boosted. The second part focuses on export diversification and strategies to reduce commodity dependence by expanding the scope of an economy's activities. The discussion draws primarily on the five case studies on LDCs from Africa and Asia to highlight challenges that they faced during the past decade – particularly during the global crises – and on how they dealt with them (or not, as the case may be).[24] The analysis also relies heavily on two other studies[25] commissioned by UNCTAD, as well as on recent UNCTAD reports.

3.1. Harnessing the opportunities of commodities

Price volatility is one of the main challenges associated with commodities. Two other problems that are often linked to the presence of natural resources are Dutch disease and rent-seeking behaviour. Dutch disease refers to the risk that commodity wealth raises the country's real exchange rate, which, in turn, reduces the competitiveness of other export sectors and shifts resources from them to the commodity sector. As a result, the economy's labour-intensive sectors, notably manufacturing, suffer, and its

[24] Two tables in the annex provide basic indicators of the performance of these five countries during the past decade and during 2007-09.
[25] Golub et al., 2011 and Lines, 2011.

commodity dependence increases. As for the problem of rent-seeking for personal and/or corporate gain, it can lead to a system of political patronage and corruption.

These challenges notwithstanding, commodities do not merely present a threat to a resource-rich economy's development, but they also offer opportunities. Clearly, a rise in commodity prices improves the economic condition of an exporting country and, as discussed in the previous section, higher commodity prices were instrumental to the growth of many LDCs in the years leading up to the global financial and economic crisis. The first country to graduate from LDC status, diamond-rich Botswana, in 1994, provides a successful example of how an economy can benefit from its natural resource endowments. Moreover, Botswana is still showing the way through recent vertical diversification by cutting diamonds locally instead of exporting the gems in their raw form, as most other exporters of diamonds still do. Namibia has also adopted this best practice.

In other words, natural resources present both opportunities and threats to the economic development of commodity-rich LDCs. The question, of course, is how to minimize the latter and maximize the former.[26]

3.1.1. Management of resources

The boom and bust cycle of the previous decade indicate, to a certain extent, how well commodity-rich LDCs deal with their natural resources. After all, the rise in commodity prices until mid-2008 provided an opportunity for economic growth and investment that, if well managed, could help mitigate the repercussions of the global financial and economic crisis that followed. For instance, Golub et al. (2011) characterize Mozambique as a country that has been successful in undertaking some reforms in the oil and mining sectors as well as in reporting and managing public expenditure, although there is scope for further reforms. Among its measures to increase transparency, Mozambique has applied for membership of the Extractive Industries Transparency Initiative. The country's comparatively high country policy and institutional assessment rating of 4.5 in economic management in 2009 might be seen as a reflection of the progress made.[27] Although the impact of these reforms on Mozambique's resilience to external shocks needs to be explored, it is worth noting that the country's estimated GDP growth in 2009 was 6.3 per cent.

Some other commodity-rich LDCs appear not to have taken full advantage of the boom period and, as a result, suffered more during the global financial and economic crisis from considerably slower or contracting growth. Fiscal transparency and macroeconomic management are two areas that are frequently highlighted as needing improvements.

More generally, however, the case studies are telling in that there is not much mention of commodity policy plans. In other words, there seems to be a lack of clearly

[26] Value addition is, of course, one viable strategy to capitalize on the opportunities of commodities. This particular aspect is discussed in the next section.
[27] World Bank, 2011b. The country policy and institutional assessment is a World Bank tool used to rate countries against a set of criteria. The economic management rating is the average of the scores obtained in macroeconomic management, fiscal policy and debt policy.

articulated policies in several LDCs on how to capitalize on their natural resource endowments in order to further the countries' development. The detailed investment plans that African signatories to the Comprehensive Africa Agriculture Development Programme (CAADP) have to draw up constitute a welcome initiative in this respect.

The role of increasing demand for commodities from large emerging countries in pushing up commodity prices in the 2000s points to one key feature of the previous decade: the growth of South–South cooperation. China's engagement with Africa has received considerable attention in recent years, but expanding South–South cooperation also concerns other LDCs as well as other emerging partners. This evolving partnership has the potential to make significant contributions to LDCs' economic development, as exemplified by China's and India's trade and investment linkages with Asian LDCs and China's economic ties with Angola (it had become Angola's largest importer by 2008). An example of this potential is China's willingness to help with vertical diversification by accepting to build oil refineries for Niger and Chad – a request that was denied for Nigeria for many years. At the same time, however, it is important to be aware of some of the risks involved in deepening economic relations, such as the possibility of reinforcing commodity dependence.[28]

Finally, the important point of sustainable management of resources should also be raised. This concerns both hard and soft commodities, such as the environmental consequences of mineral extraction and the overexploitation of fish. Not placing enough emphasis on sustainable management has negative consequences on the future benefits derived from the natural resources themselves as well as on the potential gains of other growth sectors, including tourism.

3.1.2. Commodity price volatility and food security

As previously discussed, commodity price volatility can have significant detrimental effects on LDCs' economic development and poverty reduction. There are, moreover, close interlinkages between commodity price volatility and food security. Measures to mitigate the adverse effects of the variability of food prices include stockpiling physical commodities and using commodity risk management tools, compensatory financing schemes, commodity exchanges[29] and social safety nets.

The case study on Cambodia lists a number of policy measures the Government took in response to the global crises.[30] The measures included cash transfers, salary increases, rice subsidies, exemption of import duties on agricultural inputs, expansion of food distribution programmes and short-term vocational training programmes to laid-off workers. The Government also launched a stimulus package that reduced bank reserve requirements and boosted investments in transportation, irrigation and agriculture. A specific example of its bid to stabilize prices is the Cambodian Government's purchase of 300 tons of rice, which was subsequently sold in urban markets at subsidized prices – up to 30 per cent below the prevailing market price. The Government complemented this subsidy, which was limited in scale, by offering

[28] UNCTAD, 2010c.
[29] Commodity exchanges have been established or mooted in Bangladesh, Cambodia, Ethiopia, Nepal, the United Republic of Tanzania, Uganda and Zambia.
[30] Runsinarith, 2011, pp. 23-25.

low-cost credit to private rice mills in order to enable them to purchase and sell larger stocks.

Benin, meanwhile, relied on three policy instruments in its response to the crises.[31] The first instrument was fiscal and included the suspension of import duties on certain agricultural products. The second one concerned the development of productive capacities through investments into the agricultural sector and credit subsidies to improve access to finance. The third instrument related to identifying ways for production to be sold. This included the government's purchase of 20,000 tons of cereals from producers; half of which was exported to Niger, while the other half was utilized as a buffer stock to regulate domestic food prices.

Two areas that have good prospects to contribute to increased food security are traditional foods and agroecology, as discussed in Lines (2011). The benefits of indigenous crops are manifold: their increased production can make countries less susceptible to the price volatility of more international crops, they can improve nutrition through a more varied diet, they are often more resilient to the effects of climate change than more international cereals and they can contribute to lower emissions of greenhouse gases from agriculture. Ecological agriculture similarly offers economic and environmental benefits, including less exposure to volatile input prices through alternatives to fertilizers and more sustainable production methods.[32]

In the long term, the paramount importance of investing in agriculture to improve food security cannot be understated. The fact that per capita food production in LDCs has been contracting since the 1970s to the extent that it was one fifth lower in 2003–05 compared with 1970–72 shows how much productivity has fallen. Similarly, yield increases in Africa have been lagging behind the growth seen in Asia and Latin America. This has a direct bearing on livelihoods, since a one per cent increase in yield can entail a poverty reduction of 0.5–0.8 per cent.[33]

In this context, there is considerable scope for reforms in several LDCs, including in terms of government support and access to and cost of finance. For instance, governments in only 7 out of 26 African LDCs allocated more than 10 per cent of their budgets to agriculture on average over the years 2003–2009 and were thus in line with the target contained in the Maputo Declaration on Agriculture and Food Security in Africa.[34] As another example, UNCTAD research from 2008 shows that only 14 per cent of the loans provided by banks in African LDCs go to agriculture, despite agriculture accounting for about one third of total value added and, on average, 86 per cent of employment in these countries.[35]

3.2. Boosting export diversification

[31] Soulé and Yérima, 2011, p. 41.
[32] See also UNCTAD, 2010g for a discussion on the linkages between agriculture, food security and climate change.
[33] UNCTAD, 2010f.
[34] Regional Strategic Analysis and Knowledge Support System (ReSAKSS), 2010.
[35] UNCTAD, 2010b, p. 67.

By definition, diversifying an economy's activities beyond traditional exports translates into reduced commodity dependence and vulnerability to external shocks. However, by no means do the benefits from diversification end there. First, sectoral diversification has been found to be closely associated with economic development.[36] For example, a study on Burundi found that increasing coffee production by 10 per cent would raise GDP by 0.3 per cent, while increasing production outside the coffee sector by 10 per cent would boost GDP by 3.5 per cent.[37] Second, although commodity-dependent LDCs can – and do – enjoy growth, the link between this growth and employment creation is loose. Manufacturing, services and agro-industry, however, offer better prospects to generate both.[38]

Diversification comes in a number of forms. For one thing, it is possible to diversify vertically, that is, to seek to exploit value addition opportunities by expanding production into upstream and downstream activities along the value chain, in other words, value addition into input sectors and resource-processing industries.[39] For another, an economy can diversify horizontally by developing other sectors – commodity related or not. Horticulture and tourism are two sectors that offer good prospects for many LDCs, with considerable backward and forward linkages, as highlighted in previous UNCTAD studies.[40] A third type of diversification is to modify and/or upgrade existing products, for example, by moving from low-end to high-end goods, developing other varieties of the products or targeting niche markets.

At this point, it is worth noting that even if the focus here is on value addition and sectoral diversification, one type of diversification that has been prominent in recent years is geographical. In particular, the destinations of LDC exports have become increasingly varied, with a greater share of exports heading to other developing countries. Related to this is the finding by Brenton and Newfarmer (2007) that a significant share of export growth in low-income countries – not only in LDCs – between 1995 and 2004 was due to existing products being exported to new markets, although the expansion of existing products in existing markets accounted for, by far, the largest contribution to export growth.

The case of Viet Nam, although not an LDC, points to several insights into diversification and economic development that are applicable to LDCs, particularly those located in Asia.[41] A significant feature of the country's policies has been the adoption of a gradualist approach towards liberalization since 1986, which has included price liberalization on agricultural crops and easing restrictions on foreign firms. In addition, the Government has made significant investments in infrastructure (9–10 per cent of GDP over the past decade) and training, and has pursued prudent macroeconomic policies. These factors have contributed to attract foreign direct investment (FDI), which has furthered an expansion from garments to footwear and electronics. Moreover, a bilateral trade agreement with the United States of America that was signed in 2000, establishing normal trade relations between the partners,

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[36] See, for example, Imbs and Wacziarg, 2003, and Carrère et al., 2007.
[37] Lim and Rugwabiza, 2009; cited in Ndimubandi, 2011.
[38] UNCTAD, 2010d, p. 22.
[39] For a discussion on the value addition of commodities, see also UNCTAD, 2011c (in particular, figure 1 and the discussion around it).
[40] UNCTAD, 2008c, and UNCTAD, 2010b.
[41] Golub et al., 2011, pp. 33-34.

contributed to exports from Viet Nam to the United States growing more than 10 times between 2001 and 2007. One of the notable challenges of this gradualist approach is the continuing dominance of inefficient state-owned enterprises in crucial services that are generally closed to FDI, such as telecommunications, transportation and finance. In sum, Viet Nam's experiences provide LDCs with valuable lessons that they can draw on as they look to diversify their own economies and foster economic growth.

The rest of this section investigates some of the key elements of export diversification. To structure the analysis, the discussion develops along three main lines: the national framework, productive capacities and the international context.

3.2.1. The national framework

It is trivial to remark that an economy's activities do not take place in a vacuum. Nevertheless, the significance of an enabling national framework for the expansion of an economy cannot be understated and, despite some progress, there is still considerable scope for LDCs to improve the environment in which firms operate. The link between economic performance and the business climate is also underlined by Golub et al. (2011), who find a positive correlation for non-oil LDCs between the country policy and institutional assessment rating and, respectively, growth of per capita income and growth in export values.

Governance

Weak governance is discussed in some of the case studies as well as in Golub et al. (2011), with the latter highlighting it as an issue that concerns LDCs in all regions. Although progress can be seen in several areas, corruption still emerges as an impediment to the expansion of the economies' activities. In addition, it is of essence that improvements in governance are not merely understood as upgrading legislation, but that reforms and rules are followed up by strong implementation and enforcement, with no exceptions.

Although improving governance is not a problem that can be resolved immediately, steps can be taken to cushion its negative impact in the interim. In Cambodia, for instance, a strong trade association and a large role for foreign firms in the garment sector have been conducive to overcoming constraints in the national environment.[42] Export-processing zones and special economic zones are other policy options. Nevertheless, it is crucial that such measures should not be pursued in place of more fundamental reforms that aim to improve governance in the long term.

Macroeconomic management

Greater macroeconomic stability has been one of the success stories of many LDCs during the past decade, with government deficits and inflation rates being brought under control. The resilience of some countries in the wake of the global crises attest to the advancements made. At the same time, however, the crises exposed weaknesses

[42] Golub et al., 2011, p. 39.

in the macroeconomic management of some LDCs, including the reliance on income from commodities. An area where there is scope for LDCs to take steps to strengthen macroeconomic management is in the mobilization of domestic resources, including tax reforms. Mozambique's initial reforms of the tax code for the mining and oil sectors might serve as one example in this regard.

The case studies on the United Republic of Tanzania and Zambia also highlight the importance aid can have for LDCs facing external shocks. The impact of the global financial and economic crisis on these countries was mentioned in the previous section, with both of them experiencing deteriorations in their fiscal deficits. The studies argue that aid, coupled with domestic resources, proved vital to support the countries in the wake of the crisis.

Business regulations

The role of private-sector development and FDI in export diversification and economic growth is a recurring feature in the case studies. However, in order to ensure a conducive business environment to boost the private sector and attract investment, it is key that firms be able to operate without having to deal with overly burdensome laws and procedures. To this end, several case studies highlight the importance of facilitating business regulations, including ease of investment and trade facilitation.

Rwanda, albeit not included among the case studies, can serve as an example to other LDCs in how to ease the cost of doing business. The country has been praised as a top reformer in recent years, moving from being ranked 150 in 2008 to 58 in 2011 out of 183 countries in the World Bank's ease of doing business index. Part of this success is due to the government making an improved business climate a priority, including by establishing a doing business task force, but what has set Rwanda apart from many other LDCs is the Government's political will and strong enforcement of reforms.

3.2.2. Productive capacities

Whereas the previous subsection looked at the national environment in which an economy's activities take place, this subsection turns to the actual means of production: LDCs' productive capacities. This broad concept can be seen as consisting of three key components: productive resources, entrepreneurial capabilities and production linkages.[43] An analysis of all aspects of these components is beyond the scope of the case studies and, hence, this note. Instead, the focus here is on two of the main elements of productive capacities that are emphasized in the case studies, that is, hard and soft infrastructure.

Hard infrastructure

The inadequacy of hard infrastructure, such as transportation systems, telecommunications, and energy supply, is frequently underlined as a major bottleneck for export diversification and economic growth in LDCs. This point has

[43] UNCTAD, 2006.

also been recognized by the LDCs themselves; several countries, such as Ethiopia and the Gambia, have been making strides to address the investment gaps, with the expansion of mobile phone networks perhaps constituting the most successful example. Still, physical infrastructure remains woefully deficient in LDCs.

The least developed countries that primarily benefited from the boom period of the last decade – commodity-rich countries, in particular – had an opportunity to address these inadequacies. However, the global financial and economic crisis put several plans on hold. For instance, the intention of the Government of the United Republic of Tanzania to raise $500 million on the international financial markets to fund infrastructure development had to be abandoned. To be able to push ahead with its plans, though, the Government provided Tsh205 billion (about $137 million) in the budget, which were to be raised by issuing long-term local bonds.

The need to restructure inefficient state-owned enterprises operating in infrastructure sectors is crucial, since an inadequate provision of telecommunications, power and the like drag down the performance of the rest of the economy. As discussed in the context of Viet Nam above, this is one of the main constraints that needs to be addressed in that country. The positive impact of reforms in infrastructure is perhaps most apparent in mobile telephony. For instance, a study on post-conflict countries in Africa finds that the liberalization of the telecommunications industry in Sierra Leone improved access to information and communications technology (ICT) products substantially, with the formation of five mobile operators contributing to the network covering 80 per cent of the country’s land and mobile cellular subscriptions per 100 people increasing from 2.4 in 2003 to 18.1 in 2008.[44]

Soft infrastructure

The notion of soft infrastructure covers several issues, ranging from governance and business regulations to adequate skilled labour and lack of access to and high cost of credit. As the two former issues were discussed above, this subsection focuses on the latter subjects.

Skills shortages are a constraint throughout the LDC grouping. Moreover, the global crises have most likely aggravated the problem. For instance, incidents have been reported in Cambodia where poor households have resorted to withdrawing children from schools as a coping strategy to deal with rising food prices, although this was the least common action among 11 broad strategies.

An example from the leather industry in Ethiopia shows how concerted and targeted efforts that include skills development can boost an industry.[45] In the face of cheap imports from China in the early 2000s, the Government launched consulting, training and marketing programmes to raise the quality of locally produced shoes in addition to working with firms to set export and productivity targets. The measures have contributed to a revival of the sector and although shoe exports remain small, they have grown since the programmes started.

[44] Ndlovu, 2011a and World Development Indicators, World Bank.
[45] Golub et al., 2011.

The problem of access to credit and of the cost of credit was hinted at above in the context of the need for investments in agriculture. More generally, the problem is to obtain credit from banks – with small- and medium-sized enterprises (SMEs) and agricultural producers being particularly affected – and, if credit is provided, to be facing prohibitively high interest rates. For instance, in the case of horticulture, UNCTAD (2010c) cites that the average interest rate in Africa stands at 12 per cent or more. However, the same report also draws attention to Ethiopia, where the Government has been subsidizing loans at 6.5 per cent to horticultural producers and exporters.

3.2.3. International environment[46]

Just as a country's production cannot be isolated from the national context, it is important to analyse the economy taking into account the international setting. The global crises – rooted, as they were, in non-LDCs – demonstrated this to devastating effect by way of their impact on LDCs.

The trade policy of trading partners can both hamper and assist export diversification of LDCs. For instance, duty-free, quota-free preferences by developed countries can act as incentives to expand the scope of LDCs' economic activities, but the non-tariff barriers that confront LDC exporters – for example, standards and technical regulations – can impose too high a cost for them to make exporting worthwhile.

Regional economic relations present opportunities for LDCs to diversify their exports, as exemplified by intraregional trade and investment flows affecting Asian LDCs. Beyond export diversification, regional cooperation can also assist in addressing common challenges, such as common regional infrastructure (rail networks, roads or hydroelectric dams) or regional initiatives to deal with the issue of food security, such as those found within the Economic Community of West African States[47] or in CAADP.

4. Lessons learned and policy recommendations

The past decade has been characterized by stark contrasts. There was the boom period, which benefited many LDCs, particularly mineral- and oil-rich countries. However, the boom period – marked as it was by higher commodity prices – also had negative consequences for several countries, with rising food insecurity being among the most detrimental effects. Finally, there was the outbreak of the global financial and economic crisis, which affected LDCs adversely across the board. What conclusions, then, can be drawn from the experiences of LDCs – and the case studies, in particular – in light of the recent global crises, especially with regard to commodity dependence?

[46] See UNCTAD, 2010a for a detailed analysis of the linkages between LDCs' development and the international economic architecture as well as for proposals for a new international development architecture.
[47] Soulé, B.G. and Yérima, B., 2011.

4.1. Lessons learned

- **There is a lack of clearly articulated commodity policies at the country level.** Despite the importance of commodities in LDC economies and some efforts to mainstream commodity policies into development strategies, it is primarily the role of commodities in trade that gets most focus in the countries. A more holistic approach that incorporates a development perspective and that takes into account the function of commodities in economic growth and poverty reduction is required.
- **Despite some progress made, there is a need for greater transparency and accountability in the management of public resources.** Fiscal transparency plays a key role in maximizing the benefits of commodity wealth, including by harnessing the opportunities from the expanding South–South relations and ensuring sustainable production.
- **Investment in agriculture in LDCs remains too low and should be boosted significantly and targeted efficiently.** Investing in agriculture to increase productivity has to be an essential part in a strategy to address food security. However, enhancing the agricultural sector in LDCs goes beyond food security: research repeatedly shows that investing in diversified agriculture has huge potential for economic growth and that GDP growth based on diversified agriculture is at least twice as effective as that of other sectors in reducing poverty.[48]
- **Although measures have been taken to foster favourable business climates, it is essential that LDCs press ahead with further reforms.** In order to promote diversification of their economies, LDCs must take additional steps to boost private sector development and attract investment in order to lay the ground for sustainable economic growth that is pro-poor and generates employment opportunities.
- **Recent global crises have had varying impacts on LDCs, with some showing strong resilience in the face of the global financial and economic crisis.** The effects of the fuel and food crises differed across LDCs, with oil and mineral exporters being among the countries that benefited the most and net food- and oil-importing countries being particularly burdened. The global financial and economic crisis, however, adversely affected LDCs across the board. Still, LDCs as a group managed to grow faster than both developed and other developing countries in 2009 and several LDCs continued to pursue prudent macroeconomic policies in the face of the crisis. Interestingly, some new and emerging sectors, such as horticulture and aquaculture, proved to be more resilient than other traditional sectors.

4.2. Policy recommendations

Generalizations are unavoidable when treating issues that pertain to a range of countries and a variety of commodities. In the discussion it is, therefore, important to

[48] World Bank, 2007.

bear in mind the heterogeneity of LDCs as well as of the commodities. By the same token, it is essential that these heterogeneities be taken into account in order to devise the optimal policy mix for each country in question. That said, there are various commonalities among LDCs in the challenges they face, and several policy options that arise from the analysis of the case studies and from the literature are consequently applicable to many LDCs. Moreover, LDCs share the same long-term goal in the area of commodities: "structural transformation leading to more diversified economies".[49]

Actions by LDCs:

- **Define a long-term vision for the country that clearly lays out, inter alia, how to link the commodity sector to the national development strategies.** LDCs should take steps to ensure that the potential of commodities to spur economic growth and reduce poverty is harnessed to the fullest. To do so, policies on how to maximize the benefits of the commodity sector should be a key component of countries' long-term development plans.
- **Institute and implement policies that improve the management of the extractive industries.** This primarily concerns LDCs with significant endowments in mineral commodities. It is linked to the previous recommendation in that governments should have clear strategies on how to capitalize on the natural resource rents to ensure that the endowments are a blessing instead of a curse or an additional trap. Any such strategy must include measures to enhance fiscal transparency and accountability, for example, by becoming compliant countries of the Extractive Industries Transparency Initiative.
- **Boost investment in agriculture and ensure that it is well targeted.** LDCs should increase their support to the agricultural sector in order to increase productivity growth and enhance food security. African LDCs should strive to reach, at a minimum, the target of 10 per cent of their budgets for agriculture, as per the Maputo Declaration. Equally important, LDCs should take steps to target investment well, for example, by boosting research and development on indigenous crops and applying a gender perspective.[50]
- **Incorporate policies dealing with climate change into commodity-based strategies.** There are strong linkages between climate change and commodities. For instance, agriculture's direct contribution to global greenhouse gas emissions has been estimated at 13 per cent, while its direct and indirect contribution amounts to some 33 per cent.[51] Thus, it is essential to pursue commodity policies that take into account climate change, for example, by providing greater support to ecological agriculture.
- **Foster private-sector development by enhancing private-sector capabilities, as well as by improving governance and business regulations.** The contribution of the private sector to countries' economic growth and poverty reduction has been increasingly recognized, but LDCs should pursue further measures to enhance this role. In addition to tackling corruption and facilitating the conduct of business, it is instrumental that LDC governments

[49] UNCTAD, 2010a, p. 192.
[50] FAO (2011b) finds that offering women the same access to productive resources as men could increase agricultural production in developing countries by 2.5-4.0 per cent.
[51] UNCTAD, 2010g.

support the development of entrepreneurial capabilities. LDCs should also be proactive in enhancing the collaboration among multi-stakeholders, building on the successes of previous public-private partnerships.

- **Improve the provision of both hard and soft infrastructure services.** Governments of LDCs must take measures across the board to strengthen infrastructure – from enhancing road and ICT networks to ensuring greater access to finance and skills. To do so, there is a need to attract investments into these services. However, these investments should not only go to new projects; it is equally important to upgrade and maintain existing infrastructure. Beyond investment, several LDCs could also boost their infrastructure by restructuring inefficient state-owned enterprises.

Actions by development partners:

- **Increase the quantity and improve the quality of official development assistance to LDCs.** Official development assistance must be boosted in order to support the actions by LDCs and, more generally, to support their economic growth and poverty reduction. The assistance needs also to be efficiently targeted. This includes a stronger focus on agriculture, whose share in total flows of official development assistance slumped from 14.8 per cent in 1987–89 to 5.5 per cent in 2007–09.[52] Thus, a stronger implementation of the $20 billion pledge made by governments that launched the Agriculture and Food Security Initiative in L'Aquila in 2009 is also necessary.
- **Pursue trade policies that are conducive to the development of LDCs.** Notwithstanding preference schemes that benefit LDCs, development partners should take further steps to promote a more favourable international trading system. This includes concluding the Doha Development Round in a way that takes into account the concerns of LDCs, reducing agricultural subsidies, supporting LDCs in meeting sanitary and phytosanitary measures and technical barriers to trade, and scaling up Aid for Trade.

Joint actions:

- **Make concerted efforts to mitigate commodity price volatility and enhance the capacity of LDCs to cope with food insecurity.** Several initiatives have been proposed on how to address commodity-related problems, including setting up physical emergency reserves, establishing a "virtual" reserve mechanism, reforming the compensatory financing schemes and improving LDC capacities to negotiate contracts.[53]
- **Avoid beggar-thy-neighbour policies.** What not to do might be just as important as what to do. Countries should avoid policies that can benefit them and harm other countries in the short term, but that have adverse effects for everyone in the long term, such as export restrictions.
- **Strengthen data collection and availability.** Up-to-date statistics are essential in making informed policy decisions, but are frequently lacking with regard to LDCs. Thus, information gathering and data availability should be enhanced through the collaboration of a range of stakeholders, including

[52] OECD.Stat (data warehouse and databases for members of the Organisation for Economic Co-operation and Development). Note that the data is not LDC-specific. Strictly speaking, the share refers to agriculture, forestry and fishing.

[53] See UNCTAD, 2010a, and UNCTAD, 2011c for more detailed explorations on policy options.

governments, international organizations, trade associations and international commodity bodies.

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Annex

Table 1. Basic indicators of the five case study countries and LDCs

	Benin	Burundi	Cambodia	United Republic of Tanzania	Zambia	LDCs
GDP growth, 2000–2009 (percentage)	3.9	3.0	8.9	7.1	5.4	7.4
GDP growth per capita, 2000–2009 (percentage)	0.6	0.1	7.2	4.1	3.0	4.9
Labour force, 2010 (millions)	3.8	4.7	8.0	22.0	4.9	377.9
of which: agriculture (percentage)	43.8	80.3	65.7	77.1	65.9	59.5
Export growth, 2000–2009 (percentage)	14.0	6.2	15.2	17.0	25.7	20.6
Import growth, 2000–2009 (percentage)	16.1	15.9	15.1	20.5	21.8	16.7
Share of primary commodities in total exports, average, 2000–2009 (percentage)	89.0	86.0	4.1	88.2	85.7	75.2
Share of FDI inflows over GDP, average, 2000–2009, (percentage)	1.9	0.4	5.0	3.3	6.5	5.0

Note: Estimated data for Benin's and Cambodia's export and import growth as well as for the share of primary commodities over GDP in Benin, Burundi and Cambodia.
Source: UNCTADstat.

Table 2. GDP growth, export growth and trade balance in the five case study countries and LDCs, 2007–2009

	Estimated GDP growth (percentage)			Export growth (percentage)			Trade balance (current United States dollars, millions)		
	2007	**2008**	**2009**	**2007**	**2008**	**2009**	**2007**	**2008**	**2009**
Benin	4.6	5.0	2.7	42.3	9.9	-12.5	-843.5	-823.0	-1002.0
Burundi	3.6	4.5	3.5	6.9	-13.3	20.1	-256.7	-348.2	-337.2
Cambodia	10.2	6.0	-2.5	10.7	15.2	-12.2	-1350.4	-1800.4	-1226.6
United Republic of Tanzania	7.1	7.5	5.5	15.5	37.0	-13.8	-3118.4	-4041.1	-3675.3
Zambia	5.8	6.3	6.3	22.5	10.4	-15.4	610.5	38.2	519.4
LDCs	8.7	7.0	4.7	24.5	37.6	-29.3	4681.3	16114.2	-17258.3

Note: Estimated data for Benin's export growth and trade balance in 2008–2009 as well as for Cambodia's export growth and trade balance in 2009.
Source: UNCTADstat.