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The Least Developed Countries 1999 Report

Overview

by the Secretary-General of UNCTAD

All references to dollars ($) in this publication are to United States dollars.

Introduction

As the decade draws to a close, it has become clear that the least developed countries (LDCs) have generally failed to derive appropriate benefits from the ongoing processes of liberalization and globalization. These processes have added new dimensions to the familiar supply-side constraints in LDCs as the latter attempt to adjust to the new, more competitive international environment. Whilst the 1980s were dubbed the "lost decade" for developing countries in general and LDCs in particular, the 1990s have become, for LDCs, the decade of increasing marginalization, inequality, poverty and social exclusion. The violence and social tensions which afflict several LDCs are caused, in part at least, by increasing deprivation and inequality.

This grim reality raises three important questions that need to be addressed as a matter of priority by the international community and the LDCs themselves, and underlies the decision of the General Assembly to convene the Third United Nations Conference on the Least Developed Countries in 2001. First, why have past efforts, by both national and international actors, to address the development problems of LDCs failed to deliver the desired results? Second, what are the critical factors that continue to depress living standards and constrain the participation of LDCs in world trade at a level that is commensurate with their potential? Finally, how can such constraints be overcome in order to enhance the productive capacities and competitiveness of LDCs, and thereby restore hope not only for sheer survival but also for the sustained improvement of living standards among the millions in these countries in the new century?

An examination of these issues in this Report reveals that underlying the LDCs' poor performance in world trade is their weak productive capacity and competitiveness, resulting from a host of structural and other supply-side constraints. The economic structures of these countries are dualistic and poorly integrated, and development interventions quite often bypass the majority of the people who still derive a livelihood from low-productivity traditional sectors. Firms are not specialized and markets for services are poorly developed, which in turn limits specialization and associated productivity gains. It is a vicious circle. Developing and sustaining competitiveness and productive capacities, like all other aspects of development, is a long, difficult and often frustrating process, but one which must be confronted by the Governments of LDCs and their development partners with unwavering resolve in a renewed spirit of solidarity and shared responsibility.

As an input to the preparatory process for the Third United Nations Conference on LDCs, to be hosted by the European Union in Brussels in 2001, this Report explores how to address this issue of supply-side constraints that has dogged LDCs for so long. The Conference affords the international community a unique opportunity to review, assess and adopt policies and measures that could effectively resolve the LDC development problematique, *including issues addressed in this Report.*

The least developed countries in an increasingly competitive global economic system

In today's global competitive environment, LDCs are at a disadvantage because the competitive edge is determined, more than anything else, by access to knowledge in both production and marketing. Thus natural resource endowments, cheap labour or other such aspects of static comparative advantage have now become subordinated to the knowledge-based dynamic comparative advantage. It is this knowledge that largely determines the competitiveness of products. Competitive strength essentially lies in productivity, which will be reflected in the quality of the products relative to their cost, and in the efficiency with which products are delivered to the market. A critical condition for the international competitiveness of countries is competitiveness in the domestic market. The latter ensures that factors of production are efficiently allocated in consonance with domestic prices, which should be more or less aligned with prices at the international level. This facilitates the transition of domestic firms to international competitiveness. LDC Governments must therefore pursue policies that encourage the evolution of a competitive business environment at home as a precondition for their competitiveness in the global markets.

For LDCs, the major elements of the structural weaknesses that underlie their poor productive capacities and competitiveness are supply-side constraints, including:

- The lack of linkages within and between productive, service and infrastructural sectors, which limits the potential for specialization and gains in productivity;
- Insufficiently developed human resources, which lead to a paucity of managerial, entrepreneurial and technical skills;
- Shortcomings in production units related to weak technological capability and adaptive research;
- Deficiencies in the physical infrastructure (e.g. transport, power and storage facilities) and such other support services as telecommunications, financial services and other technical support service institutions, particularly for marketing input and outputs; and
- The inability of LDC economies to generate adequate resources for investing in alleviating the above constraints in order to enhance productive capacity. The expected levels of financial and technical support from the international community that were meant to complement domestic resources have, in turn, not materialized.

Public policy in LDCs has a pivotal role in addressing the above problems. Macroeconomic policies, in particular their stability and predictability, are essential in this respect, but sectoral and micro, or firm-level, policies are also necessary to facilitate the development and sustain the competitiveness of productive capacity in specific sectors, industries and firms.

In addition, Governments have to provide an enabling environment to foster private sector development. The elements of such an environment include: a reliable physical infrastructure; an efficient and solvent financial system; a transparent legal and regulatory system with effective mechanisms for the enforcement of contracts; an effective competition policy that is conducive to the utilization of investment and trade opportunities; and simplified tax regimes to reduce the levels and multiplicity of taxes in order to encourage compliance. The private sector and civil society need to be involved in policy formulation and implementation if they are to understand the thrust of policy reforms, have confidence in them and understand the benefits they stand to derive from them. The involvement of all stakeholders would also provide policy reforms with a strong political base, without which reforms could falter.

Competitiveness and productivity at the firm level also need to be enhanced, in particular through changes in management styles, organizational norms and marketing systems. Reforms in this area should pay special attention to non-price aspects of competition such as continuous quality improvement, packaging, timely delivery and after-sales service.

To nurture and sustain dynamic comparative advantage there is a need for an interactive process that involves the formulation and implementation of government policy linked to action by private enterprise and other institutions. At one level, such policy and action must focus on technological development, the provision of relevant education and the inculcation of appropriate skills, which must be adaptable to new technologies. Governments and enterprises must join forces to source efficient and productive technologies and develop endogenous technological capabilities through research and development. At another level, there is a need to facilitate access by producers and exporters to market information that would feed into decisions pertaining to production and marketing strategies. Efficient means of communication are critical to the dissemination of such information.

The ultimate solution to the problem of low productive capacity and competitiveness in LDCs lies in the structural transformation of LDC economies. Enduring transformation requires the creation of integrated national economies characterized by increased specialization and growing interdependence among sectors. It is such a transformation that will create linkages between industry and agriculture, and thus engender efficient and diversified production and exports and increase the manufacturing value added of LDC export trade. LDCs and their development partners need to focus attention and resources on those areas that will enhance the internal linkages and therefore the integration of LDC economic sectors.

Part I of the Report assesses the main trends in the socio-economic development of LDCs, and examines the relevance of the Programme of Action for the Least Developed Countries for the 1990s in the light of the main developments in the globalizing world economy. Part II considers how to improve the productive capacities and competitiveness of LDCs, taking into account the nature of their export trade and the challenges they face, as well as the domestic policy options and international support measures appropriate to that end.

I. LDCs in the 1990s: improving productive capacity to meet the challenges of the twenty-first century

Developments in the least developed countries in 1998

Growth in LDCs, which had accelerated in the mid-1990s was maintained in 1998. However, the rate of growth in LDCs' gross domestic product (GDP) fell. The real average GDP growth rate for LDCs is estimated at 3.8 per cent in 1998, down by one percentage point from the average growth rate recorded by the group in 1997. This is the third successive decline in the average GDP growth rate for LDCs since the peak of just over 6.0 per cent recorded in 1995. This drop is partly a reflection of the general deceleration in world output from 4.2 per cent in 1997 to 2.5 per cent in 1998. Growth in developing countries also suffered a setback in 1998, declining to 1.8 per cent from 5.4 per cent in 1997.

The decline in LDC growth is largely underscored by the fall in world output due to the Asian financial crisis, and the subsequent financial contagion and accompanying economic crisis. During 1998, oil prices fell by a third and non-oil commodity prices fell by about 16 per cent, while metals and minerals lost a third of their peak price recorded in August 1995. The prices of non-oil commodities of interest to LDCs, with the exception of tea, continued their downward trend. The slump in world trade was even more pronounced than the fall in world output: in 1998 recorded growth in world trade collapsed to just a third (3.3 per cent) of the rate of growth in 1997 (9.9 per cent), which is the lowest growth rate since 1985.

While GDP growth in both African and Asian LDCs declined for the third successive year, output growth in Asian LDCs, at 4.0 per cent, held up better than the estimate of 3.6 per cent for African LDCs, despite the collapse of intra-Asian regional FDI flows in the wake of the Asian financial crisis. Pacific LDCs had the worst growth performance in 1998, with a steep decline in output estimated at 4.6 per cent. This was perhaps due to the poor growth performance of Solomon Islands and Vanuatu, which recorded negative growth rates estimated at 10 per cent and 2 per cent respectively. Overall, the average growth rate for the 45 LDCs for which data are available is estimated at 3.4 per cent over the period 1990 to 1998.

Although the impact of the Asian crisis on the LDC group was indirect and somewhat limited, the evolution and final resolution of the crisis are likely to influence the short-term growth prospects for this group of countries. This will be particularly the case in such areas as resource flows, especially private capital flows to Asian LDCs, and prices of non-fuel commodity exports of interest to LDCs, as well as Asia's fledgling trade and investment links, especially with African LDCs.

Apart from the above and weather factors, the prospects for LDCs’ recovery in the short term will also depend on factors such as movements in international prices, official development assistance (ODA) flows, debt service obligations and access to international markets for their major exports.

With ODA accounting for up to 70 per cent of the development budgets and 40 per cent of the recurrent budgets in a number of LDCs, short-term macroeconomic and fiscal stability as well as growth prospects will also be dependent on the volume of ODA flows, which fell to their lowest level yet (in real terms) in 1998. However, in view of increasing aid fatigue and concerns in developed countries about the effectiveness of aid, even if the overall volume of aid increases in the future, the proportion allocated to LDCs is most likely to be determined by the kind and extent of policy reforms implemented, or being implemented, by these countries. There is therefore a strong case for making a critical review of the effectiveness of policy reforms on which ODA has become, or is likely to become, conditional. Improved aid effectiveness and growing aid flows could also open up access to international capital markets for LDCs.

The effective reduction of the LDCs' debt burden would also have profound implications for their growth prospects. It would help promote investor confidence as well as release resources for much-needed investment, particularly in infrastructure, human resources development and economic diversification programmes.

A number of commodity exports of interest to LDCs continue to face restrictions in the markets of some of their major trading partners. Some of their exports are subject to tariff escalation and tariff peaks, as well as a number of non-tariff barriers. Although the members of the World Trade Organization (WTO) have acknowledged the particular interests and concerns of LDCs, including the latter's limited capacity to participate in the multilateral trading system and derive meaningful benefits from it, much remains to be done in terms of turning market access into a potent force for enhancing development prospects for LDCs.

Development finance, external debt and investment

The paucity of resources to finance the enhancement of productive capacities is among the most critical constraints on the development of LDCs. Internal mobilization of adequate development resources, through domestic savings and the production of adequate exportable surpluses, remains a distant prospect, in spite of the widely implemented economic reforms that aim to create an environment conducive to the revival of production of tradeables. While ODA, the traditional source of development finance for LDCs, has been on the decline since the beginning of the decade, access by these countries to private investment finance remains limited. The situation is further aggravated by the burden of international debt, the servicing of which is a major drain on meagre LDC resources.

In real terms, ODA flows to LDCs have fallen by 23 per cent since the beginning of the decade. Against a backdrop of a series of austerity budgets in developed countries, there has been a steady decline in the aid budgets of most donor countries, especially since 1992. The average share of aid to LDCs in the gross national product (GNP) of the Development Assistance Committee (DAC) countries of the Organisation for Economic Co-operation and Development (OECD) fell from 0.09 per cent in 1990 to 0.05 per cent in 1997. Only a third of the DAC countries met the Programme of Action threshold of 0.15 per cent of GNP as ODA to LDCs in 1997.

Given competing demands on aid resources, especially from the many humanitarian crises in different parts of the world, the future outlook for traditional ODA programmes is uncertain. The declining trend can only be reversed if there is a renewed commitment on the part of the international community to accord special priority to the development needs of the world's poorest countries. That a core of donor countries have been steadfast not only in meeting but also in surpassing the ODA targets contained in the Programme of Action suggests that such a commitment is possible. Furthermore, the United Kingdom and Germany, for example, have recently announced new aid policies that include a commitment to increase their aid budgets. Also, the Heavily Indebted Poor Counties (HIPC) initiative, which was addressed in last year's Report, has been comprehensively reviewed during 1999, and the emerging consensus, endorsed by, among others, the G-8 at its Cologne Summit in June, is that the debt relief process should be speeded up, the benefits improved and the number of beneficiary countries increased.

LDCs as a group recorded a decrease in the level of outstanding external debt, from $133 billion in 1995 to $127 billion in 1997, and a decrease in the average debt service-to-export ratio from 22 per cent in 1995 to 13 percent in 1997 as a result of rescheduling. However, even with reduced debt service ratios, many LDCs have failed to meet their debt obligations fully and have accumulated arrears, the payment of which has had to be re-rescheduled. The currently depressed commodity prices can only weaken further their debt-servicing capacity. Recent proposals to reform debt relief, especially shortening the time frame for the implementation of the HIPC initiative, applying less restrictive eligibility criteria, setting a ceiling for the share of fiscal revenue allocated to external debt service and cancelling ODA debts, could not, therefore, have come a moment too soon. It is encouraging to note the endorsement of the Enhancement Framework Proposal by the Ministers at the joint session of the Interim and Development Committees of the International Monetary Fund (IMF) and the World Bank in Washington in September 1999, which promises to expedite the resolution of the debt problem.

With the exception of a few small and island LDCs that depend heavily on tourism for foreign exchange earnings, most LDCs have invariably recorded deficits on their current accounts throughout the 1990s. The level of the deficits on the balances on goods is considerably higher than that on the balances on services for most LDCs, which reflects partly a poor productive base for merchandise exports and partly adverse terms of trade for commodities, which comprise the bulk of LDC exports. In 1997 the average deficit on the trade balance constituted 16 per cent of the combined GDP of LDCs for which figures are available. Given the fact that foreign exchange earnings for the majority of LDCs come from merchandise exports, the possibility that these countries will be able to mobilize savings from external trade is extremely remote. In fact, LDCs are forced to seek credits, mainly from multilateral institutions, to finance current account deficits. If such credits are not used to enhance productive capacity, LDCs could find themselves in a vicious circle whereby outflows in debt service payments would intensify current account deficits, creating more need for external credits.

During the second half of the 1990s the general trends in gross domestic savings as well as gross domestic investment in LDCs recovered from the extremely low levels of the 1990s, thanks mainly to economic policy reforms. The rising trend in domestic investment was, however, interrupted by the Asian financial crisis in 1997. The East Asian LDCs suffered most from the crisis because it hit foreign direct investment (FDI) from within the Asian region on which they so heavily depend. Although an increasing number of LDCs have recorded positive savings rates during this period, these rates are still too low, and LDCs in general continue to depend on external inflows for the greater part of their domestic investments. Investment levels in LDC economies, however, still fall far short of what is required to finance replacement needs of the capital stock, let alone create new productive capacity.

Although FDI flows to LDCs have been rising in the second half of the 1990s, their levels do not match existing needs. The flows are also unevenly distributed across countries and sectors, and are often unpredictable. A more even sectoral distribution of FDI seems to be emerging, but a disproportionately large share of FDI to LDCs is still channelled into extractive activities in the oil, mining and forestry sectors, with limited backward- and forward-linkage effects on LDC economies. Developments regarding FDI to Asian LDCs indicate the increasing significance of private capital inflows to LDCs from other developing countries in the context of intraregional FDI. African LDCs and their neighbours need to take the cue from their Asian counterparts so that the promotion of intraregional FDI becomes part of their agenda for regional integration.

Against this background, the urgent need for further measures to increase ODA, relieve debt and promote FDI to LDCs cannot be overemphasized. The effectiveness of aid as a catalyst for development lies in improving its efficiency by targeting it to support the most critical constraints in the economy, and reducing the transaction costs associated with its delivery to the target populations. The challenge facing LDCs is how to overcome the fatigue and even cynicism that have come to be associated with ODA, by demonstrating its effectiveness in enhancing the productive capacities of their economies. As for donors, the challenge is to make a significant and substantial increase in the aggregate level of external support in line with the commitments undertaken in the Programme of Action.

A preliminary assessment of progress in the implementation of the Programme of Action for the Least Developed Countries for the 1990s

The Programme of Action for the Least Developed Countries for the 1990s was adopted at the Second United Nations Conference on LDCs in Paris, in 1990. Its prime objective is to halt any further deterioration in the socio-economic situation of LDCs and to reactivate and accelerate growth and development in these countries and, in the process, to set them on the path of sustained growth and development. The policies and measures in support of these objectives have revolved around the following major areas: the establishment of a macroeconomic policy framework conducive to sustained economic growth and long-term development; the development and mobilization of human resources; the development, expansion and modernization of the productive base; reversing the trend towards environmental degradation; the promotion of an integrated policy of rural development aimed at increasing food production, enhancing rural incomes and non-agricultural sector activities; and providing adequate external support.

At the national level, the arrangements for the implementation of the Programme of Action were based on existing mechanisms for policy dialogue, programme coordination and resource mobilization, such as the United Nations Development Programme (UNDP) round tables and World Bank consultative groups. At the regional level, the United Nations regional economic commissions were entrusted with the role of monitoring progress in economic cooperation between LDCs and other developing countries, particularly countries in the same region. Cluster meetings were to be organized regularly in order to improve and strengthen existing regional and subregional cooperation arrangements. At the global level, UNCTAD, in cooperation with other relevant organizations of the United Nations system, was designated as the focal point for the review, appraisal and follow-up of the implementation of the Programme of Action.

Since the adoption of the Programme of Action in 1990, there have been major developments at the global level – such as the acceleration of the twin processes of globalization and liberalization, and the conclusion of the WTO agreements – with significant implications for its implementation. These developments have had an influence on the role of the State in development, the kind of development or economic policies States are able to legitimately pursue or implement, and the nature of the relationship between various actors – States, donors, the private sector and civil society – in the field of development. Furthermore, political and civil strife in several LDCs, with spillover effects in neighbouring countries (such as the influx of refugees), have weakened the capacities of some LDCs to formulate, let alone implement, development strategies or policies. Also, two unanticipated developments have interacted to reduce the volume of financial resources available to LDCs to support their domestic policy reforms. These are the drastic 22.6 per cent decline (in real terms) in LDCs' share of ODA, and the increase in the number of countries categorized as LDCs, from 42 in 1990 to 48 today (only Botswana has graduated from the list), with a concomitant 36 per cent increase in the total population of these countries between 1990 and 1997. The number of claimants on diminishing aid resources has therefore increased.

Despite the efforts of several LDCs to implement macroeconomic policy reforms over the past decade or so, the implementation of the Programme of Action has not only suffered a major setback from the continuous decline in ODA flows, but also from unacceptably high levels of LDCs' indebtedness, as mentioned above. A comprehensive assessment of the implementation of the Programme of Action at country level is in progress as part of the preparations for the Third United Nations Conference on LDCs, which were officially launched in July 1999. However, an assessment of progress in the implementation of the

Programme of Action undertaken in the mid-term review in 1995 noted with great concern that despite vigorous efforts by LDCs to implement economic reforms as envisaged by the Programme, LDCs as a group had not been able to meet many of its objectives, and their overall socio-economic situation had continued to deteriorate because of both domestic and external factors. One conclusion that could be drawn from the above assessment and the subsequent reviews by the Trade and Development Board of UNCTAD and the annual LDC ministerial meetings is that the Programme of Action has not been effective in transforming the economies of LDCs. The United Nations General Assembly, in its resolution 52/187 of 18 December 1997 on the implementation of the Programme of Action, noted, with concern the continued marginalization of LDCs in world trade, the reduced flow of development resources to these countries and their serious debt problems, and decided to convene the Third United Nations Conference on LDCs.

One of the key issues to be addressed through the ongoing assessment of the implementation of the Programme of Action is whether the poor performance of LDCs is a result of inadequacies in its implementation, including monitoring and follow-up, or deficiencies in the elements of the Programme itself. Even without a comprehensive assessment of progress in the implementation of the Programme, something could be said about the mechanism for its implementation. This Report shows that, for a variety of reasons, round-table meetings and consultative groups at the country level (which are a proxy indicator of success in policy dialogue between Governments and donors, and in coordination and resource mobilization) did not cover all LDCs, were not organized on a systematic basis, did not always succeed in mobilizing adequate financing, and did not adequately address LDCs' debt which is negotiated separately under the Paris Club. In fact, these meetings were not linked to the Programme of Action for which they were supposed to be the "backbone". Thus, while there might be some correlation between the Programme of Action and changes observed in economic and social developments in LDCs, it is difficult to prove direct causation.

While the Economic Commission for Africa (ECA) and the Economic and Social Commission for Asia and the Pacific (ESCAP) have undertaken regular reviews at regional level, the weakest link in the implementation mechanism has been the lack of organization of regional cluster meetings and sectoral reviews by agencies. At the global level, monitoring has been more effective. The regular reviews of the implementation of the Programme of Action undertaken by the General Assembly, UNCTAD Conferences and the Trade and Development Board, have been instrumental in increasing the "visibility" of LDCs and in focusing the attention of the international community on their plight. For example, growing awareness of the plight of LDCs has led to their being granted special and differential treatment measures in some of the WTO agreements and, as pointed out above, the campaign for increasing the resource flows and providing LDCs with broader debt relief has intensified. Within the United Nations system and in other international organizations, special units or offices have been established to be responsible for LDC issues. Several activities have been implemented by these organizations and agencies in LDCs. The convening by WTO in 1997 of the High-Level Meeting on Integrated Initiatives for Least Developed Countries' Trade Development is further testimony to the increasing attention being paid by the international community to the special difficulties facing LDCs.

In retrospect, the Programme of Action was rather optimistic about resource availability and global economic developments. Arguably, the most pressing development concern of LDCs on the eve of the twenty-first century could be encapsulated in one short question: what can be done about supply-side constraints so as to enable LDCs to produce more competitively for domestic as well as international markets? This is not in any way to underestimate other constraints on trade relating to market access, especially tariff peaks and tariff escalation for products of special interest to LDCs. However, the "technocratic approach" to addressing the development challenges facing LDCs, which conceives of their development problems within a narrow focus of trade policy, needs to be changed. Developing the necessary capacity to be competitive in global trade demands a holistic approach in which all the relevant actors (the State, donors, the private sector and civil society) have more or less equal stakes. It is also important that the development partners of LDCs fulfil their commitments by meeting the aid target of 0.15 per cent of GNP set in the Substantial New Programme of Action for the 1980s for the Least Developed Countries adopted at the First United Nations Conference on LDCs, held in Paris in 1981.

Any future action plan for LDCs would need to be flexible enough to accommodate unexpected developments in the global economy and to meet the challenges of LDCs in the next century. Most importantly, there is a need to clearly spell out goals and objectives, as well as to make specific resource commitments and identify the necessary performance criteria by which to assess whether the goals have been attained at specific time periods.

II. Overcoming marginalization by enhancing productive capacities and competitiveness in LDCs

Trends and options in export production in the least developed countries

Although LDCs constituted about 10 per cent of the world's population in 1997, their share in world imports was only 0.6 per cent and in world exports a minuscule 0.4 per cent. These shares represent declines of more than 40 per cent since 1980 and are a testimony to the increasing marginalization of LDCs.

An analysis of data on the value of exports by LDCs in the period 1995-1997 shows two distinct characteristics in the pattern of their export trade. First, merchandise trade continues to dominate LDC exports; only a quarter of LDCs derive a greater part of their foreign exchange from exporting services. Second, LDC exports tend to be concentrated, with either one product, or a narrow range of products, accounting for a substantial share of the export earnings.

Three-quarters of LDCs derived their export earnings predominantly from merchandise exports in 1995-1997, and in more than half of these the value of merchandise exports was more than three times the value of services exports. The majority had a highly concentrated merchandise export structure, with one dominant, usually agricultural or mineral, export product accounting for more than half of the total value of exports of goods. Only one country had a merchandise export structure that was dominated by manufactured product in the form of garments. The bulk of LDC merchandise, therefore, is exported with little or no value added.

Among the 12 LDCs where exports of services dominate, the value of exported services in 1995-1997 was more than double the value of exported goods in at least 10 countries. Three-quarters of these LDCs had a highly concentrated service export structure, with one dominant international service accounting for more than half the value of the total exports of services in 1995-1997. Most of these LDCs are small, mostly island, States that have benefited from specializing in producing tradeable services, especially tourism and/or international transport, without which they might have enjoyed little or no growth, considering their limited basis for merchandise trade.

Slightly more than half of the LDCs which derived their export earnings mainly from services in 1995-1997 had an export structure that had been dominated by merchandise 10 years earlier. Production data indicate that such changes in the relative proportions of goods and services in the export content of these LDCs are a function of a rapid growth in international service activities relative to merchandise export activities. While tourist arrivals in LDCs grew by about three-and-a-half times between 1980 and 1997, the volumes of the major LDC commodity exports grew by only a third during the same period. For LDCs as a group, export concentration remained more or less unchanged between 1985 and 1997, a testimony to the general failure of efforts at export diversification in these countries.

In a few LDCs, a sizeable part of foreign exchange inflows comes not as export earnings but in the form of such "external rental income" as remittances from nationals living abroad, income from trust funds, royalties from fishing rights and large foreign expenditure due to the presence of military bases. Although "rental" activities are accepted and encouraged as a legitimate option for countries that are severely handicapped in their supply capacities (in particular, very small and remote LDCs), it is important for such countries to seek to establish more secure alternative sources of foreign exchange based on productive activities.

The most critical factor behind the LDCs' failure to improve their exports is poor productivity. This is evident in agriculture, which is a major foreign exchange earner for most LDCs and employs the majority of the working population. Generally speaking, the 1990s have been characterized by stagnation in productivity for agricultural commodities. Figures on yield for the major LDC agricultural commodities up to 1997 indicate that productivity in respect of sugar cane, coffee and tobacco was stagnant from 1990 to 1997. Productivity in respect of cotton and cocoa began to stagnate from the late 1980s and did not record any appreciable improvement during the 1990s. Productivity in tea was stagnant throughout the first half of the 1990s and only began to pick up in 1996.

Apart from fluctuations related to price incentives, the stagnant or falling rural productivity is related mostly to failure to improve rural technologies through requisite investments in technical support services, including the marketing of inputs and outputs, and the provision of credit, research, environmental management and extension services to farmers. In those LDCs for which data are available, falling productivity in export crops has been shown to be a major cause of their increasing unprofitability to farmers, who have responded by shifting resources into the production of better-paying food crops, for which domestic markets are rising as a result of rapid urbanization. While it makes economic sense for individual farmers to shift resources away from less profitable export crops into more profitable staples, in LDCs that are not net food-importers, this might be counter-productive if sufficient export income is not generated elsewhere to sustain basic imports to keep the economy working. It cannot be over-emphasized that sustainable transformation of LDC agriculture has to be based on improvements in overall factor productivity.

Information on productivity trends in the oil and mineral sectors, which play a significant role in the export economies of 25 LDCs, is not available. However, output trends, for all their limitations, are a good proxy for productivity trends. With the exception of gold, whose annual output increased by about 15 times between 1986 and 1997, output of other major LDC minerals, especially diamonds, iron and copper, was marked by declining trends during the same period. The worst decline was recorded in copper, the output of which in 1997 was only around 40 per cent of that in 1986. This decline in the production of minerals during the 1990s reflects inadequate investment in the LDC mining sector, probably due to investment policies in the producing countries, issues pertaining to security and political stability, and the downward trend in mineral prices.

Unlike the mineral sector, the oil sector seems to have enjoyed substantial investments. However, most of the investment has been in the production of crude oil. The downstream refining subsector is fraught with serious production bottlenecks. The general trend in the production of crude and related products in LDCs for the period 1986-1997 indicates a progressive increase throughout the period. In 1997, the volume of crude output was nearly four times the 1986 output. It is important to point out, however, that about 95 per cent of the output during this period was produced by Angola and Yemen.

In trying to diversify their exports, LDCs should seek to invest in improving productivity in both traditional and new export activities, and in developing exports for both global and niche markets. In targeting global markets, LDCs need to exploit and even seek to enhance their comparative advantages. Although niche trade relations are particularly helpful in respect of small and vulnerable countries whose survival may lie only in marketing relatively unique assets, other LDCs stand to benefit from such relations as well. Apart from the immediate opportunities they offer, niche markets can also serve as entry points that could enable LDC producers and exporters to learn production skills and develop marketing expertise and other capabilities that they could deploy to develop new exports for more mainstream, or global, markets.

Policies to improve productive capacities and competitiveness in the least developed countries

Issues of productive capacity relate to the structural weaknesses in LDCs such as weak management capacity, weak institutional development, low levels of technology and lack of technological capacity, as well as inefficient transportation, communication and customs procedures which undermine trade efficiency. In addition to pricing issues, these factors also play a large part in the non-competitiveness of much of LDCs' domestic and export trade. While structural adjustment programmes being implemented by several LDCs since the early 1980s have addressed the price factors more or less successfully, these programmes have had limited impact in addressing the structural weaknesses in LDCs.

The magnitude of the development *problématique* confronting LDCs has to be analysed within a context in which certain specific policy instruments, such as the infant industry protection and fiscal incentives employed by the newly industrializing economies of South-East Asia, fall foul of WTO disciplines, or can only be deployed under specified and restricted circumstances. In this Report, the policy issues for enhancing productive capacities and promoting competitiveness in LDCs are analysed from the cross-sectoral and sectoral analytical perspectives. The broad developmental strategy for LDCs is identified as one that reorients the incentive structure in favour of the tradeables sector in order to produce more efficiently for domestic and external markets in response to ever-increasing competition in global markets.

Following from this, it is argued that macroeconomic policies have to be defined within a long-term framework with a view to attaining macroeconomic stability, enhancing the external orientation of the economy and boosting export diversification. A complementary set of macro-level policies is necessary to create an enabling environment for human resources development, the development of technological capability, and the strengthening of the institutional framework and physical infrastructure to support the enhancement of productive capacities and competitiveness. Policies to promote trade efficiency have to be designed and implemented in collaboration with three main players, namely, the Government, service providers and traders. In view of the paucity of medium-sized enterprises, a coherent programme, to support the growth of enterprises, from micro to small and from small to medium-sized, is required to develop the critical mass of domestic enterprises in the middle range.

Also, LDCs need to implement sectoral policies if the static and dynamic comparative advantages of the various sectors are to be translated into a diversified export base and increases in the production and export of value-added goods and services.

Agriculture and fisheries

The policies recommended for agriculture are underscored by two main arguments. First, despite the slow growth in world import demand and the secular decline in real prices associated with primary commodity production, LDCs could increase their foreign exchange earnings from these products through productivity improvements and greater competitiveness in agriculture. Second, LDCs have to intensify export diversification programmes with a view to enhancing and stabilizing their earnings from trade. They could exploit the strong world demand in niche products such as fish and fish products, some fresh and processed fruits, vegetables and nuts, spices and other horticultural products.

To attain these objectives, LDCs have to pursue a multi-pronged agricultural development strategy to diversify their production within the context of existing opportunities and long-term comparative costs. This strategy would include the use of appropriate irrigation technologies to complement rainfed agriculture, intensified research into soil and water resources, institutional and market reforms for the supply of agricultural inputs and outputs and addressing infrastructural bottlenecks to support efficient agricultural production. To improve their competitiveness in agriculture, LDCs will need to find innovative ways of extending credit to farmers, especially smallholders, improve rural facilities and address gender bias relating to access to land, financial resources, agricultural inputs and extension services.

In the case of forestry and fisheries, LDCs need to institute mechanisms for monitoring resource levels in order to guard against over-exploitation and associated ecological stress. It would be appropriate to initiate studies that would inform policy-making on appropriate environmental protection measures.

Many agricultural activities, particularly in horticulture and fisheries would benefit from technical support from development partners in order to the meet sanitary and phytosanitary requirements of export markets, provided the developed countries apply such measures in a transparent and consistent manner.

Mining

Mining policy in LDCs has to be pursued at two different but interrelated levels: one relating to large-scale, capital-intensive mining operations, mostly State or foreign-owned; and one relating to small-scale and artisanal mining activities, which have persisted in several LDCs that have mining potential.

With regard to the first set of policies, Governments have to provide clear policy guidelines, supported by the necessary legislation and services to stimulate private sector interest in mining. Among other things, this would include developing the State's capacity to implement regulatory and promotional functions, undertaking geological mapping and maintaining an updated database on mineral resources, and providing an adequate physical infrastructure to facilitate the development of the mining sector. Linked to the overall policy of developing technological capability, the Government could facilitate access to simple modern and environmentally sensitive technologies, provide mineral laboratories and promote the establishment and development of professional and industrial mining associations.

The second set of policies, directed at the artisanal and small-scale mining subsector should aim to enhance its productive capacity and competitiveness, as well as protect the livelihoods of the large sections of the populations dependent on activities in this sector. This would require a more transparent licensing procedure for artisanal miners and mineral dealers, accompanied by the strict enforcement of a new code of conduct in mining and mineral processing designed to eliminate fraudulent practices and to limit environmental degradation.

Donor assistance would be invaluable in helping LDC Governments to design and implement technical assistance programmes aimed, *inter alia*, at introducing new technologies, skills, and modern methods of management to the mining sector. Support is also needed to help Governments to adequately compensate and resettle communities whose traditional livelihoods would be dislocated by mining activities.

Manufacturing

The policies recommended to develop the manufacturing sector in LDCs are premised on the proposition that structural change in LDC economies requires a strategy of simultaneous development of agriculture and industry, and the integration of the informal sector, which in LDCs is substantial in relation to the formal sector and provides livelihoods for a significant proportion of their populations.

Manufacturing activities, in general, would benefit from policy measures that create a more competitive macroeconomic environment. Any protection that is offered to infant industries must be in line with article XVIII (B) and (C) of the General Agreement on Tariffs and Trade (GATT) 1994, and should only be for dynamic sectors that are expanding in line with the dynamic comparative advantage. The usefulness of such protection would be enhanced significantly if it were to be accompanied by an obligation to export a rising share of the output of each firm enjoying such protection.

Policies that support the development of LDCs' small and medium-sized enterprises (SMEs) into competitive formal sector enterprises would strengthen the manufacturing sectors in these countries. The central lessons distilled from case studies indicate that support for SMEs should be based on specific organizational principles, and that public intervention should be:

- Focused and strategic, based on the sectoral needs of clusters;
- Channelled through private sector local representatives and self-help (stakeholder) bodies such as industry associations;
- Flexible, demand-oriented and customer-driven, rather than top-down and supply-driven; and
- Decentralized to community and regional levels.

Moreover, services such as finance, training and innovation support should be integrated rather than provided separately.

The objective of intervention should be to enhance horizontal and vertical ties among enterprises, promote collective efficiency, speed up learning, respond to the market and reduce transaction costs. Productivity results from a *network effect;* a combination of greater access to specialized information, greater supplier-producer interaction, access to high-quality public goods and innovation induced by rivalry within clusters. There is a growing consensus on the need for enterprise support, which calls for meso-level institutions to support SMEs. As such supporting institutions are weak in LDCs, most of these countries will need to start with the basics, by setting up institutions to provide training in business and management skills, and technical information support, as well as setting up industrial standards and quality agencies. In addition, institutions should be set up to promote an innovation culture among firms, to develop basic research skills and to provide export information services and credit support (investment credit, working capital and export credit).

Tourism

The greatest challenge facing the tourist sector in LDCs is to promote tourism on a sustainable basis, that is, to ensure that tourism has limited negative impacts on the host communities and the environment, and develops linkages to other sectors of the economy, while providing satisfaction to tourists and contributing positively to government income.

LDC Governments interested in developing this sector would need to develop action plans and create or adapt institutions to oversee the development of human resources and the tourist infrastructure, and the implementation of promotional strategies and legislation, and the involvement of the private sector. These plans should be based on an integrated approach to tourism, economic development and environmental protection, and should ensure the participation and inclusion of previously excluded groups.

Programmes to address the paucity of skilled labour in the tourist sector in LDCs have to be linked to the human resource development strategies for the whole economy, but must above all aim at ensuring high-quality services, which are crucial to the competitiveness of tourism in LDCs. Governments, in association with the private sector, have to upgrade the tourist infrastructure, including hotels, tourist attractions and access roads. The sector could also benefit from new promotional strategies aimed at repackaging tourist products to increase value for tourists, as well as to develop the appropriate mix between mass, low-value tourism and low-volume, high-value tourism.

Other unexploited opportunities

Music, arts, crafts and information technology-based services are some of the unexploited opportunities open to LDCs. The realization of the foreign exchange-earning potential of the music sector in LDCs would require education and training, and proper legislation and an implementation mechanism, especially to enforce copyrights. Furthermore, the financing necessary to design and market innovative products would have to be found, as well as investment in new technology to produce final products able to meet the stiff competition in export markets.

The exploitation of information technologies for the export of services, starting from labour-intensive data-entry services, would need to be closely coordinated with policies to develop domestic technological capability in LDCs. This is because the development of a competitive information-services export sector has to be complemented by rapid growth in domestic information technology applications and the development of the necessary local expertise and facilities, based on a modern telecommunications infrastructure, if LDCs' service exports are to be globally competitive.

All the above sectoral strategies need to be accompanied by comprehensive and integrated initiatives aimed at developing the physical and social infrastructure. However, given the level of resources required for such investment on the one hand, and the magnitude of the resource constraints facing LDCs on the other, the international community needs to demonstrate the political will necessary to mobilize support that would complement the efforts of LDCs to develop their productive capacities.

International support measures to enhance productive capacities and competitiveness in LDCs

There is no doubt that LDCs cannot by themselves address the structural weaknesses that undermine their productive capacities and competitiveness. This understanding has informed several initiatives in the past by the international donor community on their behalf. These include the aid target of 0.15 per cent set in 1981 (mentioned above) and, most recently, the Integrated Framework for Trade-related Technical Assistance to support LDCs, adopted at the 1997 WTO High-Level Meeting on Integrated Initiatives for Least Developed Countries' Trade Development. As already mentioned, several factors, including the decline in ODA flows since the beginning of the 1990s and the seemingly intractable debt overhang of many LDCs, have frustrated these initiatives. At the same time, LDCs have been frustrated in their efforts to export the few products in which they enjoy some comparative advantage, despite the existence of several preferential market-access schemes for their exports

A three-pronged approach to international support measures for LDCs is recommended. First, realistic and effective schemes to enhance market access for LDC products, particularly those in which they already have established capacities, need to be worked out. Second, there is a need to reduce the drain of LDCs' resources, especially in the form of debt service payments, capital flight and excessive expenditure on military hardware. And third, measures are needed to assist LDCs in enhancing the productive capacity of their economies. In this context, international support measures for LDCs should be delivered in two different but related packages: a "priority needs" package and a "long-term financial and technical assistance" package.

The *priority needs* package for immediate to short-term needs would consist of measures to substantially enhance market access for LDC exports, address the debt problem, increase resource inflows, upgrade skills, support trade services and deal with natural disasters. Two main measures are proposed in the Report as part of the market access scheme for LDCs. First, developed countries should provide technical assistance to LDCs to train their officials and exporters in the proper use of GSP schemes, particularly considering that an UNCTAD study in the early 1990s revealed that the utilization rate for these schemes was below 50 per cent. The simplification of these schemes would also greatly encourage their use by LDC exporters. Second, the developed countries should undertake to provide enhanced market access for export products that LDCs currently produce, notably by completely eliminating tariffs on LDC exports. This is particularly relevant as those products in which LDCs enjoy comparative advantage (especially labour-intensive products), or which offer possible trade diversification for LDCs - such as leather, footwear and vegetable oil - are subject to tariff escalation and tariff peaks. At a minimum, tariff peaks and tariff escalation have to be addressed as a matter of urgency during the forthcoming Third WTO Ministerial Conference in Seattle.

While the recent improvements to the HIPC initiative are welcomed, the debt overhang of LDCs should still be included in the priority package to ensure that immediate debt relief is provided to all debt-distressed LDCs. The continuous decline in ODA flows to LDCs has to be halted and additional resources should be directed towards upgrading skills, supporting social services as part of human resources development, and promoting trade efficiency.

Those LDCs prone to natural disasters need international assistance in disaster management. Expertise in disaster-preparedness and post-disaster or rehabilitation activities (supported by finance) and training, incorporating the risk of hazards in the design of broader economic strategy in order to mitigate the economic impacts of disasters, would limit shocks and losses related to natural disasters suffered by LDCs.

Long-term financial and technical assistance would be needed to fund major investments in physical and social infrastructure, which are crucial to "crowd in" private investments in LDCs. Funding is needed to link up production centres to domestic and export markets by road, to improve port, handling and customs facilities, to improve telecommunications facilities and thus to enhance trade efficiency, and to assure reliable power and water supplies for industry. Specific projects in both developed and developing countries to promote investment in LDCs might involve, *inter alia*, investment protection agreements, taxation allowances for companies operating in LDCs and the development of venture capital funds for projects in LDCs.

Donor support would be invaluable in supporting enterprise development and enhancing the competitiveness of LDC economies by facilitating access to new technology, especially for SMEs, improving technological capabilities and providing training to improve local management skills.

Technical assistance to improve the functioning of regional trading arrangements of which LDCs are members would help LDCs to become more competitive. By providing larger markets, these regional trading arrangements would make LDCs more attractive to potential investors, encourage the pooling of resources for research on trade and trade-related issues peculiar to the region, and, most importantly, introduce LDC exporters to the exacting standards of global markets.

It is also crucial that LDCs should be assisted in developing their trade negotiating capacities to enable them to participate effectively in future trade negotiations, as well as to understand and follow closely developments in WTO and defend their trading interests individually and collectively.

These international support measures need to be designed and implemented in a manner that complements the domestic programmes and policies employed by each LDC to address supply-side weaknesses. In this way, not only would costly duplication of projects be avoided, but the efficacy of their domestic programmes would also be greatly enhanced.

The preparatory processes for three major upcoming international events – the Third WTO Ministerial Conference, the Tenth United Nations Conference on Trade and Development (UNCTAD X) and, especially, the Third United Nations Conference on the Least Developed Countries – give LDCs and their development partners a rare opportunity to evolve a new strategy of development cooperation to benefit LDCs. This new strategy should be underscored by a desire to search for innovative approaches to mobilizing additional ODA and private capital flows in order to complement LDCs' own efforts to enhance their productive capacities and competitiveness in a rapidly evolving global context. Only then can the advent of globalization become, to paraphrase Shakespeare, the high tide that if taken at the flood could lead on to great fortune.