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LDCs' boom and bust in the 2000s: the turbulent decade

The recent global financial, economic, food and fuel crises reaffirmed the unsustainable foundations of LDCs' growth during the 2000s, and their propensity to boom-bust cycles. LDCs weathered the global recession better than anticipated but their apparent macroeconomic resilience clearly reflected the pickup of commodity prices in the second half of the year, and the increased lending by multilateral donors (in Sub-Saharan Africa the IMF financing commitments increased fivefold between 2008 and 2009. The medium-term outlook is fraught with risks: many LDCs' debt burdens have increased, peaking food prices, and uncertainty regarding increased ODA flows from crises-stricken developed countries. The economic downturn should be seen as a wake-up call, highlighting the weaknesses of the prevailing development paradigm, which pays little attention to LDCs' structural dynamics. LDCs' recent performance, even prior to the crisis, demonstrate that in most cases their pattern of growth contributed only modestly to the development of productive capacities. Moreover, the growth acceleration of LDCs during the 2000s was not inclusive, and led to sluggish progress in terms of MDG achievements. Looking ahead, unless LDCs actively pursue economic diversification and reorient their economies toward a path of inclusive growth, there is little hope that they will increase their resilience to shocks, and put an end to the boom-bust cycles.

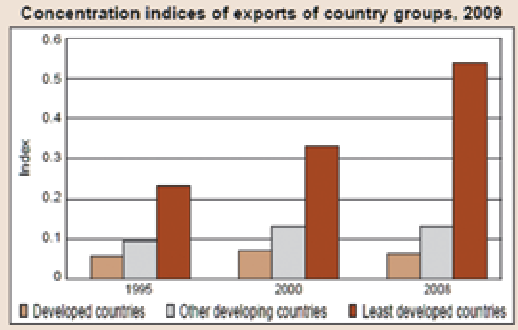
Prior to the crises many LDCs improved in key macroeconomic variables, e.g., in the period from 2002 to 2007, 16 individual LDCs, and the LDC group as a whole, achieved a GDP growth rate of over 7% per annum, in line with the Brussels Programme of Action target. The boom was largely underpinned by external factors, such as the expansion of world trade (in value and volume), soaring international prices for key primary commodities, and record levels of ODA, foreign direct investment (FDI) and remittances inflows into the LDC region. In turn, the favorable international environment led to some improvements in LDCs' macroeconomic situation and wider access to foreign exchange.

Growth was, however, unevenly distributed across countries according to their structural conditions. Oil and mineral exporters benefited disproportionately from improved terms of trade, booming export revenues, and growing inflows of FDI. Conversely, 14 individual countries posted declining or sluggishly increasing GDP per capita. Furthermore, LDCs' performance shows that the pattern of growth followed by most during the 2000s was unsustainable, fragile and not inclusive. This document focuses on the unsustainable foundations of the boom and its ephemeral nature.

The unsustainable foundations of the boom: commodity dependence

Beyond macroeconomic variables the export-led growth model, which underpinned most LDCs' development strategies during this period, contributed weakly to redress LDCs structural vulnerabilities. Rapid GDP growth and export expansion were accompanied by heightened primary commodities dependence, to the extent that the share of fuel and mineral in LDCs' total exports increased from 43% in the year 2000 to 67% in 2007. The increasing concentration of exports on primary commodities was associated with faster depletion of environmental capital, leading to a decline in LDCs' net adjusted savings. Similarly, the boom left LDCs' distance from the productivity frontier basically unchanged, while agriculture productivity gaps between developed economies and other developing countries widened. Agricultural stagnation constrained the supply-response of the farming sector, leading to increased dependence on food imports - LDCs' food import bill increased from over USD 9 billion in 2002, to USD 24 billion in 2008.

Concentration indices of exports of country groups, 2009



Sluggish capital accumulation and structural change

Despite high rates of GDP growth, the boom did not address the longstanding issue of inadequate investment in LDCs. Although gross fixed capital formation increased slightly, reaching 21% of GDP in 2007, it continued to be significantly lower than in other developing countries, and lower than what was required to overcome the infrastructural gap and foster investment and technological upgrading. Throughout this period domestic savings remained stagnant at around 10% of GDP, with the notable exception of oil exporters, which witnessed a surge in saving rates. As a consequence, the majority of LDCs in the 2000s increased their reliance on foreign savings to finance capital accumulation. LDCs' heavy reliance on natural resources is also testified to by the fact that net adjusted savings, which take into account the imputed cost of natural resources' depletion, fell steadily since the mid 1990s.

Moreover, the pattern of structural change underlying LDCs' boom witnessed the expansion of extractive industries, whereas the agricultural and manufacturing sectors, which employ the majority of the labor force, and offer the largest scope for increasing returns respectively, were largely by-passed. In addition, 27 LDCs experienced some degree of de-industrialization in the 2000-2008 period. Particularly in the case of African LDCs, the unbalanced pattern of growth led to an 'employment challenge', as the economic expansion did not generate sufficient productive employment in manufacturing and services to absorb those seeking work outside the agricultural sector. The limited effects of growth in terms of employment creation largely explain why the boom translated only weakly into poverty reduction and progress towards the MDGs.

The bust: spillovers of the 'great recession'

The unsustainable foundations of the boom period surfaced in early 2008 but became even more obvious later in the year, when the LDCs were hit by the global recession. The series of external shocks exerted a differential impact across LDC economies depending on their structural conditions, such as pattern of specialization, main export destinations, size of FDI and remittances flows relative to the domestic economy.

Financial contagion

Direct financial contagion has been particularly acute in countries such as Uganda and Zambia, where foreign investors played a prominent role in the banking and financial sectors. The direct fallout of the financial turmoil had rather limited effect in LDCs, owing to their anemic financial development and shallow integration in the international capital markets. In contrast, the adverse spillovers of the global recession have been harsher, and exacerbated LDCs' chronic debt vulnerabilities.

Falling exports

The contraction of export revenues (-26% in 2009) has been the main transmission channel of the crises in LDCs, due to the slump in the world demand and the free fall of commodity prices between the last quarter of 2008 and the first quarter of 2009. In this respect, exports' concentration and structural composition were amongst the major determinants of the differential impact of the crisis, underscoring once more the importance of economic diversification. In fact, price and demand shocks have varied largely by product, hitting fuels and mineral commodities disproportionately. Services exports, notably tourism and maritime transport, were also affected by the downturn, with severe consequences for island LDCs.

Capital flows and fiscal adjustments

In 2009 FDI inflows to LDCs contracted by 13% compared to 2008; simultaneously, there were signs of rising profit repatriations on the part of companies trying to consolidate their balance sheets. Remittances inflows to LDCs proved more resilient to the crisis, although their expansion slowed considerably relative to the double digit growth of the previous years. While the decline in private capital flows was less than for other developing countries, the LDCs were in a more difficult situation because of their chronic external vulnerability and their limited resources to cope with the shock.

Furthermore, due to the slowdown in economic activity, many LDCs experienced a fall in public revenue at a time when countercyclical interventions were needed. Again, owing to the free fall of commodity prices in the international markets, these adverse fiscal effects were particularly sharp in countries like Angola, Chad, Niger and Zambia, where mineral-related proceeds played a prominent role in the revenue structure.

Overall impact of the bust

The overall macroeconomic impact of the crisis has been somewhat attenuated by the rebound of commodity prices in the second half of 2009, and by substantial increases in concessional financing from the IMF, the World Bank and regional development banks. Despite these factors, the fallout of the global recession has slashed GDP growth rates in most LDCs. The growth slowdown in 2009 was, on average, in the range of 3 percentage points, but the outcome was significantly worse for several oil-and mineral-exporters, as well as various island LDCs. Angola, Cambodia, Chad, Equatorial Guinea and Maldives all suffered double-digit decelerations in their GDP growth, while Madagascar, Mauritania, Myanmar, Samoa, Sierra Leone, and the Solomon Islands saw their growth rates curtailed by more than 5 percentage points.

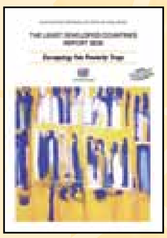
Beyond the heterogeneity which characterized the impact of the global recession on individual countries, the shock was so severe that in 2009 GDP per capita declined in 19 LDC economies. This suggests that, behind some apparent macroeconomic resilience, the downturn entailed severe social costs; all the more so since it came on top of the distress provoked by the food and fuel price hikes of 2008.

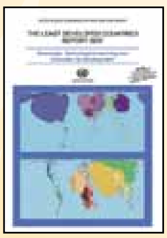
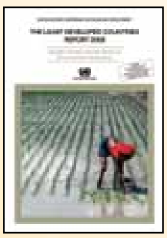
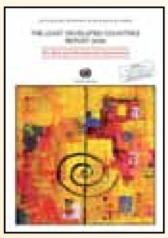
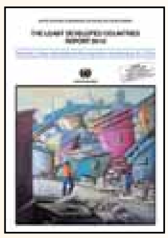
Looking ahead

Overall, though LDCs have weathered the crisis better than initially feared, recovery in 2010 is likely to be weaker than in other developing countries, and LDCs medium-term outlook remains fraught with risks. With slowdowns in investment levels, LDCs' economic recovery will depend largely on the speed of rebound in the rest of the world and, notably, on the increased support by international donors.

The global recovery, however, is uneven and fraught with risks, while most donors seem reluctant to increase their external assistance at a time of mounting pressureto cut public deficits. Meanwhile, a number of LDCs continue to be prone to debt vulnerabilities and many others have incurred additional debt in order to cope with the effects of the crises. In spite of the HIPC and MDRI initiatives, a total of 10 LDCs suffered debt distress (4 HIPCs at pre-decision point, 5 interim HIPCs and 1 non-HIPC), and another 10 were at high risk of debt distress in 2010.

Faced with this scenario, the proneness of LDC economies to boom-bust cycles, the lack of structural transformation and their vulnerability to external shocks call for a far-reaching reappraisal of the prevailing development paradigm, and for the creation of new international development architecture (NIDA). It is imperative that the LDC economies alter their current course toward a new more inclusive development path. Structural transformation conducive to the expansion of their productive capacities, and the diversification of their economies should be at the core of their new development strategies.

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