

FROM BRUSSELS TO ISTANBUL
***Key development challenges
facing the Least Developed Countries***

Compilation of documents of
pre-conference events organized by UNCTAD
in preparation for the
Fourth United Nations Conference
on the Least Developed Countries
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BUILDING PRODUCTIVE CAPACITIES IN THE LDCS FOR INCLUSIVE AND SUSTAINABLE DEVELOPMENT

UNCTAD Pre-conference Event for the Fourth United Nations Conference on the Least Developed Countries

Palais des Nations, Geneva, 27-29 October 2010

Summary report

1. The UNCTAD pre-conference event for the Fourth United Nations Conference on the Least Developed Countries (LDC-IV) on “Building productive capacities in the LDCs for inclusive and sustainable development” was held in Geneva from 27 to 29 October 2010. The event was part of a series of pre-conference activities which United Nations organizations and specialized agencies organize in line with their mandate and expertise to facilitate intergovernmental preparations and to raise the profile of the LDC-IV Conference. The theme built on UNCTAD’s long-standing work on building productive capacities in LDCs.¹ This work has demonstrated that a productive capacities-led policy approach is a prerequisite for achieving sustained economic growth and inclusive development in LDCs.

2. The UNCTAD pre-conference event was inaugurated by a high-level segment, which was chaired by H.E. Mr. Luis Manuel Piantini Munnigh, President of the Trade and Development Board. Statements at the high-level segment were delivered by Mr. Supachai Panitchpakdi, Secretary-General, UNCTAD; Mr. Cheick Sidi Diarra, Under-Secretary-General and High Representative for the Least Developed Countries, Landlocked Developing Countries and Small Island Developing States; H.E. Mr. Felix Mutati, Minister of Commerce, Trade and Industry, Zambia; H.E. Mr. Minendra Prasad Rijal, Minister of Federal Affairs, Parliamentary Affairs, Constituent Assembly and Culture, Nepal; H.E. Mr. H. Bozkurt Aran, Ambassador and Permanent Representative of Turkey; and Ms. Andra Koke, Trade and Development Division, Directorate-General for Trade, European Union, Brussels.

3. The ensuing thematic sessions were devoted to the following issues: (a) Addressing key issues in building productive capacities in LDCs; (b) The role of trade in the development of productive capacities; (c) Building productive capacities in LDCs through foreign direct investment (FDI) and domestic enterprise development; and (d) The contributions of science, technology and innovation and trade logistics. The overall discussion is summarized schematically in a Mind Map in Annex 1.

1 See UNCTAD (2006): *The Least Developed Countries Report 2006: Developing Productive Capacities*; UNCTAD (2007): *The Least Developed Countries Report 2007: Knowledge, Technological Learning and Innovation for Development*; UNCTAD (2009): *The Least Developed Countries Report 2009: The State and Development Governance*; UNCTAD (2010): *The Least Developed Countries Report 2010: Towards a New International Architecture for LDCs*; and the background document for the pre-conference event: UNCTAD (2010) *Developing Productive Capacities in Least Developed Countries: Issues for discussion*, UNCTAD/ALDC/2010/1.

I. Basic messages

4. The major messages of the pre-conference event were:
 - (a) The development of productive capacities in LDCs is critically important in order to reduce their structural weaknesses, to promote sustainable growth, to enhance their beneficial participation in international trade and to achieve substantial poverty reduction and mass improvements in human well-being. Developing productive capacities should be a central theme in the programme of action which will be agreed in Istanbul in May 2011;
 - (b) The best approach to developing productive capacities in the LDCs is an integrated policy approach encompassing national policies, international policies and South–South development cooperation. In such an approach, LDCs themselves should take the lead in devising targeted and coherently articulated national policies to promote productive capacity development. These national efforts should be vigorously backed up with enhanced international support mechanisms and development-friendly global economic regimes, and also supported through enhanced South–South development cooperation between LDCs and other developing countries, and also amongst LDCs;
 - (c) It is difficult to identify a single productive capacity development strategy for all LDCs owing to the heterogeneity of their economies. However, two general principles which should be followed are (a) the development of productive capacities without attention to market demand – national, regional and global – will certainly fail; and (b) a successful market-based approach to developing productive capacities must include an important role for the State which harnesses the energies of the private sector in pursuit of private profit to achieve national productive capacity development goals. Ensuring peace and predictability, acting pragmatically, providing public goods through public investment, and creating private sector capabilities are all important roles for the State in a market-based approach. Good governance of productive capacity development implies that the pendulum swings neither too far towards State dirigisme nor too far towards market laissez-faire, but rather enlists the private sector and civil society in the strategy formulation and adopts a mixed economy approach for strategy implementation in which markets and State work hand-in-hand;
 - (d) Enhanced international support for LDCs should promote the development of productive capacities. There are major unrealized opportunities for enhanced international support mechanisms for LDCs and improvements in global economic regimes to promote the development of productive capacities in LDCs. These opportunities particularly exist in the areas of (a) development aid, debt relief and contingency finance; (b) trade; (c) commodities; (d) investment; (e) technology; and (f) trade logistics. In realizing these opportunities, attention must be paid to the challenges of climate change adaptation and mitigation;

- (e) The ownership by the LDCs of the process of developing their productive capacities is paramount and should not be undermined by the delivery of international support. Moreover, voice and representation in international decision-making is the key to ensuring that both LDC-specific international measures and global economic regimes are LDC-development-friendly;
- (f) Enhanced South–South development cooperation should also promote the development of productive capacities. There are major unrealized opportunities for enhanced South–South development cooperation to promote the development of productive capacities in LDCs. These opportunities exist in (a) regional cooperation (for example, in physical infrastructure investment and regional technology hubs); (b) new partnerships with dynamic developing countries which are based on South–South solidarity principles and draw upon recent experience of development challenges; and (c) new forms of LDC–LDC development cooperation which have hitherto been ignored.

II. General rationale and priorities

A. What are productive capacities and how do they develop?

5. The productive capacities of a country are essentially a matter of what that country is able to produce efficiently and competitively. The productive capacities of a country develop when its abilities to efficiently and competitively produce an increasing range of higher value added goods and services increase. This process occurs through expanding investment – in physical, human, social and environmental capital – and also through technological acquisition and innovation. The process is manifested in the diversification of national economies, structural transformation and a more beneficial integration into the global economy, and these changes themselves facilitate the potential for further investment and innovation in a virtuous circle.

6. Seen in these broad terms, the development of productive capacities should not be reduced to the development of export supply capacities, though the latter are certainly part of the process. Developing productive capacities should also not be reduced to investments in Millennium Development Goal (MDG) targets. Investments in health, education and other aspects of MDG achievement should appropriately be seen as aspects of developing productive capacities. But developing productive capacities goes beyond these targets and seeks to sustainably achieve MDG targets through embedding the MDGs in a broad economic development framework.

7. For developing meaningful and sustainable productive capacity, LDCs could also consider their dynamic comparative advantage with selective interventions in certain identified sectors that can be promoted to break into competitive manufacturing production and services sectors and which exert greater forward and backward linkage effects.

B. Why productive capacities matter

8. Low-income countries which have successfully escaped the low-equilibrium trap – such as East Asian industrializers – have done so through developing productive capacities. These countries have addressed mass poverty through structural transformation and the expansion of employment opportunities rather than aimed to alleviate poverty for a minority or provide help to the most vulnerable.

9. The importance of productive capacities for LDCs is multi-dimensional. Developing the productive capacities of LDCs will help to (a) address structural weaknesses and prevent acceleration of marginalization of the LDCs in global economy; (b) promote international competitiveness and to increase participation in international trade; (c) accelerate MDG achievement and poverty reduction; (d) provide sufficient productive and decent employment opportunities; (e) harness LDC creativity and in particular youth power; and (f) help the LDCs to adapt to and mitigate climate change.

10. The structural weaknesses of the LDCs are fundamentally due to the low level of development of their productive capacities. In spite of relatively high growth rates during the boom preceding the current crisis, the LDCs have not been able to reduce their structural weaknesses. The type of their integration with the world economy has actually increased some of the weaknesses. For example, exports of the LDCs are now more concentrated in few products, mainly commodities, than was the case 10 years ago. Even more important is the marginalization of the LDCs in the global economy, as exemplified by the fact that their exports of goods now represent only 1.1 per cent of the world trade, down from 1.7 per cent in the 1970s. These intertwined structural vulnerabilities continue to constrain the long-term development prospects of the LDCs.

11. The competitiveness of the LDCs in most goods and services is low. They compete on the world market mostly with commodities they produce or with products that are characterized by very low value added and by the labour-intensive production processes. In the latter case, the LDCs compete solely on the basis of a very cheap labour. The productivity gap between workers in Organization for Economic Cooperation and Development (OECD) countries and the LDCs is on average 22 to 1 in favour of the former. Without a much greater use of technology and higher levels of investment, the LDCs will be unable to bridge that gap and to compete successfully on the world market with countries that possess much higher productivity.

12. One of the fundamental challenges the LDCs face is that of creating sufficient and decent employment opportunities for all. With the process of demographic transition in full swing, the LDCs have young and growing populations (on average, about 70 per cent of the population is below 30 years of age) that need productive and decent employment. For example, it has been estimated for Mali that the number of new entrants to the labour force was 171,800 in 2005 and will increase until reaching 447,800 per annum in 2045. The same figures for Madagascar are 286,200 in 2005 and 473,400 in 2035.

13. Addressing this difficult employment challenge is critical both for economic growth and poverty reduction in the LDCs. Without the development of productive capacities there can be no success and the demographic dividend will be turned into complex humanitarian emergencies. MDG achievements will be more substantial and sustainable if linked to the economic development framework of developing productive capacities. Progress in reducing poverty rates in the LDCs in a substantial and sustainable way can only be achieved through broad economic progress that opens opportunities for much broader swaths of population than has been the case so far.

14. Focusing on development of productive capacities implies seeing the LDCs not simply in terms of their deep poverty reduction needs but also in terms of their latent and unharnessed potential and their creativity. This is especially true of the potential of their young, but often unemployed or underemployed population. Young people are a driving and dynamic force, but at the same time the most vulnerable to terrorism and extremism if faced with lack of opportunities for a decent life. Youth-focused policies and programmes should be a priority in the LDCs, especially in those communities that have been torn apart by conflict. The creativity of the LDC populations has so far only marginally been used for productive purposes, and this could be turned into a crucial part of the national development strategy of many countries.

15. As the scale of the climate change challenge confronting the LDCs is likely to be enormous and as these countries will be disproportionately affected, the response to that challenge will be of growing importance in the near future. The LDCs' multiple vulnerabilities, on account of their low level of economic and human development, have to be addressed in an integral way to prepare them for that challenge. Adaptation to and mitigation of climate change in the LDCs could best be addressed through development of productive capacities in such a way that increasing production, access and use of modern energy sources in the LDCs (which is currently a key deficit) is achieved, and at the same time LDC economies successfully transit to a low-carbon growth path.

16. In the wake of the financial, food and fuel crises there is a need to focus on linking finance to the development of the real economy. Productive capacity development is the heart of this. It involves capital accumulation (investment in physical infrastructure, plant and equipment, education and skills), technological progress (innovation involving new products, processes, organizational structures and markets, as well as knowledge), and structural change (from low-productivity, diminishing-returns sectors to high-productivity, increasing-returns sectors, and strengthening of the linkages within the national economy).

C. Priorities

17. It is difficult to identify a single productive capacity development strategy for all the LDCs owing to the heterogeneity of their economies. A key issue for individual countries is therefore to identify their own priorities. This is relevant both

in terms of sectors (outputs) and ingredients (inputs). The proper mix of sectoral production will vary among the LDCs, depending on their current structure of production, but also their future national development policies. The development of productive capacities is a country-specific process and each country should follow its own route. In addition, the experience of successful late industrializers shows that priorities change over time and with that the mix of sectoral production of individual countries.

18. Various sectors were identified as potentially relevant in the meeting: (a) agriculture and in particular food production; (b) manufacturing; (c) upgrading primary commodity production; (d) creative industries; and (e) services, including tourism. However, two common priorities for LDCs should be to develop the agricultural sector and to diversify the economy and promote structural transformation.

19. Agriculture is important because it is still the largest employing sector in many LDCs. The neglect of that sector in the last three decades has to be reversed. The food crisis that hit the LDCs disproportionately has placed the issue of food security back on the agenda of the policymakers. The supply of basic wage goods is crucial for non-inflationary expansion of employment opportunities.

20. However, the development of agriculture should be done in a way which facilitates the diversification of the LDC economies and structural transformation. In this regard, past experience shows that the development of manufacturing activities and related producer services can enable increasing returns to scale as well as provide increasing employment for young population. With the inevitable modernization of the production processes in agriculture, there will be a growing surplus of labour in rural areas that will seek productive employment in urban centers. A dynamic manufacturing sector, along with some services such as tourism and creative industries, could provide productive and decent jobs for them.

21. The critical ingredients of productive capacity development include finance, knowledge, energy, physical infrastructure and water. The data show major deficits in the LDCs in terms of these ingredients. For example, the average years of schooling of the adult population within the LDCs in 2000 was only three years, which is less than what it was in other developing countries back in 1960. Only 16 per cent of the LDC population is estimated to have had access to electricity in 2002, compared with 53 per cent in other developing countries and 99 per cent in OECD countries. Addressing these issues in the future is crucial as these ingredients are indispensable for the development of productive capacities in the LDCs.

22. Whilst key ingredients vary amongst the LDCs according to their specific circumstances, two common priorities for LDCs should be (a) improvement and expansion of physical infrastructure (in particular, transport and communications and production of modern energy); and (b) human resource development through education, training and skills development. People are the key resource of the LDCs and special attention should be paid to the gender dimension of the process of education and training.

23. The development of productive capacities without attention to market demand will certainly fail. Both investment and innovation are animated by demand, and structural transformation changes in response to demand variations as incomes rise. Countries should not only pay attention to present demand but also future demand. This was relevant, for example, in relation to developing dynamic competitive advantage.

24. A common general approach for LDC governments to develop productive capacities would be to promote a virtuous circle between rising demand and the key processes through which productive capacities develop – namely, capital accumulation (physical and human), technological progress and structural change. That would help them break out of the low-equilibrium trap characterized by a low level of economic development, lack of infrastructure, structural impediments to growth and high level of poverty.

25. LDCs should pay attention to national, regional and global markets. The current export-led model focused exclusively on the international markets will not be enough for development of productive capacities. That approach has resulted in a pattern of specialization of LDC economies that has made them even more vulnerable and dependent on fluctuations of international prices of their export products. A rebalancing of the focus towards domestic and regional markets could potentially be very beneficial for the LDCs. The data show that trade of the LDCs with regional partners is at the same time more diversified and also has a higher value-added and higher technological content than the trade with developed countries. Thus, it should be encouraged and could serve to enhance diversification of the LDC economies.

D. Dynamics and timing

26. Questions of sequencing are important in prioritizing the development of productive capacities. It is a cumulative process in which achievements in the previous phase provide the basis for what can be done next. The Chinese principle of “one commitment, many steps” was singled out as relevant here.

27. It was also emphasized that there was a need to improve what exists before attempting to build new things (innovate). In particular, the LDCs should first try what some call “a nearby diversification” since that is relatively easy to achieve. For example, it is relatively easy to diversify from the production of t-shirts to formal shirts since almost all inputs needed for the latter are already available in the production of the former. As the “nearby diversification” progresses in a successful manner, the country could attempt to diversify to more sophisticated products using the experience and knowledge accumulated previously.

III. An integrated approach to developing productive capacities

28. There is a need for an integrated approach to developing productive capacities which include national policies, international policies and South–South

cooperation between other developing countries and the LDCs. Specifically, it is imperative to avoid the situation where the efforts to develop productive capacities with the help of national policies are undermined with the effects of international policies, or vice versa. The development dimension of the current global economic regimes is generally weak and there is a need for a reform of the global economic regimes to make them more development-friendly and a need to complement them with a new generation of LDC-specific international support mechanisms focused on development of productive capacities.

A. National policies

29. A critical issue with regard to national policies is the role of the State. It was argued that, in this regard, the pendulum should not swing too far towards State *dirigisme* or market fundamentalism. This suggested the need for an approach in which the State seeks to harness the energies of the private sector in the pursuit of private profit towards the achievement of national development goals. Pragmatism and predictability are critical. Moreover, one basic function of the State is to ensure peace. These 6 Ps (pendulum, predictability, pragmatism, peace, public goods and private sector) provide the basis for a broad understanding of a “market-based approach” to developing productive capacities in which the State has an important developmental role.

30. Stimulating productive investment, building technological capabilities and strengthening linkages within and across sectors and between different enterprises will be slow and inadequate if left only to markets. As is well known, markets in the LDCs are incomplete and do not function as well as in developed economies, and not as neatly as predicted by the abstract economic models. For that reason, a key developmental role for the State is to provide proper incentives for the private sector where markets do not provide them or provide incentives such that social and private returns are not aligned. A major developmental role of the State is to foster the investment–profit nexus in expanding private profits act as an incentive for investment, a source of investment and outcome of investment. Fostering such an investment–profits nexus in the national economy of LDCs would result in development of a more vibrant private sector, capable of producing and exporting higher value added products.

31. Institutions also matter in the development of productive capacities. Building and effectively maintaining State capacities to support the development of productive capacities (e.g. ministries of agriculture and industry, different State agencies, and so on) is vital. Good governance, and in particular good development governance, is also critical, as is social capital. In building developmental State capabilities in the LDCs, it is necessary to look at successful models and then identify which principles and practices provide a good fit with the circumstances of each LDC.

32. National policies to develop productive capacities should be multi-level. They should include growth-oriented macro-economic policies, sector-specific development policies (agriculture, industry, services), trade policies, labour market

policies (which are vital to ensure the link between production, employment and poverty reduction) and micro-level enterprise development policies.

B. International policies

33. In discussing international policies to develop productive capacities, ownership of national development strategies and policy space were identified as critical. In the past, ownership of national policies has been undermined by policy conditionality. The donor focus on MDGs has also resulted in a shift in the composition of aid away from production sectors and economic infrastructure. Policy space is also critical for promoting the development of productive capacities. In order to achieve the goals of their national development strategies, the LDCs need more policy space than they currently have.

34. General global economic regimes in relation to finance and commodities were seen as negatively impacting on LDCs. They are of great importance for the LDCs because of the need to reduce the global volatility, which could have very negative impacts in their economies owing to high exposure to shocks and inability to cope with them. The climate change regime was also vital and this is going to be a source of new vulnerabilities which could undermine any achievements in productive capacity development.

35. The focus of discussion of international policies was on possible international support mechanisms (deliverables) in relation to aid, contingency finance, debt relief, trade, investment, technology and trade logistics. These are discussed in more detail in section D (below).

36. Finally, there is a need to give greater voice and representation to the LDCs in international forums to ensure that global regimes are LDC-development friendly and LDC-specific international support measures are tailored to their needs. LDCs will have a total of 1 billion inhabitants by 2017, but have no representation in the G-20.

C. South-South development cooperation

37. South-South development cooperation can usefully support the development of productive capacities in the LDCs. In 2007–2008, developing countries were the source of 62 per cent of LDC merchandise imports and the destination of slightly more than half of their merchandise exports. Emerging developing countries such as China, India and Brazil are rapidly becoming major trading partners of the LDCs, and will likely be even more important in the future.

38. Regional cooperation can play a strong role in helping to support the development of productive capacities in LDCs, in particular through (a) promoting more diversified trade development; (b) achieving economies of scale in infrastructure investment; (c) reducing trade transaction costs through logistics improvement; (d) attracting FDI; and (e) creating regional technology hubs. The

LDCs could more rapidly reduce the impediments to development of productive capacities by cooperating with their regional partners. This is especially important for landlocked as well as for small island developing LDCs.

39. Interregional South-South cooperation is also a major opportunity for developing productive capacities. Official finance, FDI, technology transfer, technological cooperation and exchange of policy experience are key channels for South-South development cooperation, as well as the provision of new market opportunities, for example through offering Duty-Free Quota-Free (DFQF) market access. As regards the latter, the Global System of Trade Preferences among Developing Countries offers an important mechanism to advance trade of LDCs.

40. Examples of LDC-LDC cooperation were also provided in the meeting in relation to microfinance institutions whereby institutions from Cambodia expanded their operations to include Sierra Leone, and those from Bangladesh did the same in Ethiopia. Exchange of experience between the LDCs is an important untapped resource for developing productive capacities in the LDCs. The potential for further developing LDC-LDC policy and institutional exchange needs to be actively explored.

IV. Enhancing international support for developing productive capacities in LDCs: some actionable deliverables

A. Development aid, contingency finance and debt relief

41. Although there was some increase of official development assistance (ODA) during the past decade in comparison with the previous one, the increase in aid flows was proportional to the increase in aid flows to other developing countries. In addition, the aggregate ratio of ODA to gross national income of the OECD Development Assistance Committee countries increased from 0.05 per cent in 2000 to 0.09 per cent in 2008, but that was still way below the lower target of 0.15 per cent set by the Brussels Programme of Action for the LDCs. Increasing aid flows in line with commitments will be vital in rectifying productive capacity development deficits in LDCs.

42. Aid has also been provided increasingly for social uses in the last three decades, and the share going to production sectors and economic infrastructure has declined. The development of productive capacities cannot be achieved on the basis of domestic resources alone, so this unbalanced trend in the uses of ODA should be reversed along with the expansion of aid to levels in line with commitments. Providing more aid for the development of productive capacities will result in a closer alignment of ODA with the LDCs' development priorities as expressed in their national development strategies and poverty reduction strategies.

43. Developing productive capacities requires both traditional and innovative uses of aid. Traditional uses of aid include the provision of financial resources to meet physical infrastructure needs, renewed investment in agricultural productivity

growth, and financial support for increased investment in education across spectrum, not simply in primary education. Major financing gaps exist in all these areas. In 2004, for example, ODA commitments for economic infrastructure and private capital flows for energy, telecommunications and transport to LDCs amounted of 0.7 per cent of GDP. But annual infrastructure investment needs in these sectors plus water and sanitation may be equivalent to 7.5–9 per cent of GDP.

44. Developing productive capacities also requires innovative uses of aid which support private sector development. Good examples are (a) UNCTAD's proposed International SPARK initiative, in which development aid would be used to support enterprise innovation in LDCs through national technology funds; and (b) the United Nations Capital Development Fund initiative MicroLead, in which successful microfinance institutions located in developing countries, including some LDCs such as Bangladesh, are funded to invest in building microfinance capacities in selected LDCs. In both these cases, ODA can leverage other forms of development finance. Another possible innovative use of development aid would be to support and complement migrants' remittances, which are important to many LDCs, in a way which supported their use for the development of productive capacities rather than simply for immediate consumption needs. Remittances are an important source of external finance in an increasing number of LDCs.

45. More improvements are required in the delivery of aid, as this is currently undermining ownership of national development strategies, which is essential for developing productive capacities. The mismatch between increasing attention to productive capacities in national development strategies by LDC governments and the increasing focus of donors on directly financing specific MDG targets is an example of this problem.

46. Contingency finance is a topic of increasing importance for the LDCs, but is mostly neglected in the present international architecture. Structural vulnerability of the LDCs and their elevated exposure to shocks of different kinds have a high correlation with the lack of productive capacity and lack of diversification of their economies. This is especially true of small island developing LDCs characterized by a narrow economic base, heavily dependent on trade of primary commodities in the agricultural sector, and with very limited sources of international finance (trade, ODA and workers' remittances). The fuel, food and financial crises which the LDCs successively experienced from 2007 onwards indicate the need for anti-shock financing facilities that would be available in a timely manner and would provide sufficient financing to counter the magnitude of the shock.

47. In spite of the various debt-relief initiatives such as HIPC and MDRI, the debt issue is still relevant for the LDCs. There are 14 LDCs which still remain in debt distress or at high risk of debt distress, but were not identified as HIPCs or had not reached the completion point. In addition, there are 6 LDCs at high risk of debt distress and a further 5 at moderate risk, despite benefiting from substantial debt relief. The debt service of the LDCs today takes away about \$6.3 billion per year. Debt relief could be a great support factor for capital accumulation in the LDCs

if a debt-swap mechanism could be agreed to transform it into the investment in productive sector, this could have very positive effects.

B. Trade

48. The development of productive capacities – and building of international competitiveness – can potentially be furthered through commercially meaningful duty-free and quota-free (DFQF) market access for products of the LDCs by developed countries, with pragmatic, user-friendly, transparent, simplified and easily administered rules of origin, as agreed in the 2005 WTO Ministerial Conference. Consideration could be given to de-linking the DFQF treatment from the Doha agenda for immediate delivery to LDCs. The early conclusion of the WTO Doha Trade Round with development outcomes is important. In this regard for LDCs, improved market access in services Mode 4 and a waiver granted on preferential market access for the LDCs' services exports, complemented with meaningful services offers and an ambitious, expeditious and specific outcome for cotton trade-related aspects, would also be important. Other priorities for the LDCs include addressing non-tariff barriers, especially regarding product standards and trade facilitation. Market access for LDCs should be effective and commercially meaningful affecting manufactures, agricultural products and services and cover products where LDCs can potentially export.

49. DFQF treatment to the LDCs by developing countries in a position to do so should be made more generous with no or limited exceptions to product coverage and flexible rules of origin requirements, and accompanied by direct aid for trade assistance, investment and technology transfer from these developing countries to the LDCs to build up their productive and supply capacities to take advantage of the preferential market access.

50. Future development of the LDC economies would need to rely on promoting sectors with dynamic comparative advantage through pro-active policy measures and support mechanisms. With that aim, the LDCs should take advantage of their existing policy space and international support regimes, including special and differential treatment provisions in WTO Agreements, to promote the sectors that have dynamic comparative advantage. Findings from recent research suggest that what countries export today matters for their growth and diversification in the future. From that perspective, total reliance on primary sectors (commodities and natural resource-rich exports) by the LDCs is to be considered unlikely to help develop value added productive capacity and achieve diversification and structural transformation.

51. Priority could be given to the development of sustainable agriculture, such as organic agriculture and sustainable fishing, electronics industries, creative industries and manufacturing sectors, in order to improve exports through value addition and diversification. The development of textiles and clothing industry, including cotton production, value addition and trade, remains important for many LDCs for launching and supporting industrialization. Particular attention should be given to developing the services sector to foster services productive

capacities, such as in tourism and remittances-related sectors, Mode 4 and build up services including infrastructural services (inter alia, roads and rail networks, ports, electricity and R&D services, energy and telecommunications), that act as catalyst for competitiveness in other industries, and provide essential services for the population.

52. Improvements in special and differential treatment provisions in WTO agreements will also help LDCs develop their productive capacities. In the Doha Round, members should commit to improving special and differential treatment in WTO Agreements for LDCs by making them more precise, concrete and operational. Particular attention could be placed on strengthening provisions that can enhance the supply and productive capacities of LDCs such as the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) Article 66.2.

53. LDCs could be assisted in registering their products with unique identities as geographical indications, and help boost production and increase income for producers including the poor, youth and women.

54. Clean technologies should be made available to LDCs to enable them to undertake more environmentally-friendly production methods.

55. Accession to the WTO of 12 LDCs currently in this process should be expedited and the terms of accession made consistent with their levels of development.

56. The provision of a generalized system of preferences on services for LDCs could be considered and developed by preference providers.

57. Enhanced access of LDCs to adequate and affordable trade financing is necessary.

58. Regional integration among developing countries should expand market opportunities for the LDCs, increase investment and reduce costs of doing business and trade. Regional integration groupings should provide effective market access for the LDCs by removing tariff and non-tariff barriers, especially as regards unrealistic rules of origin, SPS and TBT norms, and provide simplified trading regimes for cross-border trade. The LDCs should be able to trade more effectively with other members of the regional integration grouping, as a stepping stone toward wider trade with the international community. In terms of sequencing and phasing of economic integration, the regional integration should come first, followed by extra-regional relations. In this regard, the current approach toward trade agreements with developed countries, such as the African, Caribbean and Pacific Group of States (ACP)–European Union (EU) economic partnerships agreements could be revisited to incorporate measures that more effectively enhance intra-ACP integration and building up of productive and trading capacities of the LDCs. Regional integration must create wider markets and reduce market entry barriers, harmonize programmes and documentation, reduce costs of doing business, enhance market access, and create one border posts - and addressing all these should lead to improved productive capacities.

59. Coordination and harmonization of multiple regional integration initiatives are needed in regions where such overlap exists. An example is the agreement by countries of COMESA, SADC and EAC to create a single free trade area for the 33 countries of the region. This single trading area would then constitute a major pillar for the realization of the African Economic Community foreseen in the Abuja Treaty adopted by African Heads of State and Government.

60. Interregional South–South trade cooperation, including through the Global System of Trade Preferences among Developing Countries (GSTP), should improve trade opportunities for LDCs.

61. The Enhanced Integrated Framework (EIF) should ensure an increasing supply of aid for trade development in the LDCs. It should be based on the principle of ownership and be used to coordinate donor support to the LDCs and leverage additional donor support. Aid for trade support to the LDCs should set out in realistic and concrete terms the assistance to be provided to assist the LDCs carry out structural transformation and economic and market diversification. Such support should also be directed towards the development of competitive national, regional and international trade facilitation systems, including transportation, to improve administrative procedures and lower transaction costs through supply chains. Such assistance should further assist the LDCs to rebuild productive capacities and regain trading opportunities lost as a result of natural disasters and civil conflicts. Such existing mechanisms as the EIF and aid for trade should be more fully developed, improved and exploited before introducing new initiatives. The WTO Third Global Aid for Trade Review in 2011 should provide an opportunity to assess evidence on the impact of such assistance on the LDCs.

C. Trade logistics

62. Trade logistics are of paramount importance to the LDCs. These economies have been on the margins of the world economy not only because of their limited export supply, but also because of an inadequate logistics to reach markets of developed and other developing countries. With the rapid increase of globalization and the emergence of global value chains, good logistics have become even more important.

63. LDCs are often confronted with a growing “connectivity” gap as their connection to global transport networks is not as good as that of more developed economies. This reduces their trade competitiveness, leading to lower trade volumes, which in turn reduce the economic viability of private and public investments in infrastructures and trade facilitation. While trade and transport facilitation is usually a good long-term investment, it still requires substantial financial resources, and for LDCs there are many competing policy priorities.

64. There is ample space to improve trade logistics in the LDCs, especially by simplifying transit regimes. Trade transaction costs of import/export procedure could be as high as 10 per cent of the value of traded goods, so crossing borders could be a very costly affair for potential exporting firms. Trade facilitation can

bring down these costs substantially. Improving the efficiency of these processes is an essential component of a comprehensive strategy to better exploit export opportunities.

65. Regional approaches to infrastructure development are advisable since the indivisibility of infrastructure and the massive financing needs for investing in infrastructure cannot be dealt with on a national scale. Many trade and transport facilitation solutions require regional cooperation, e.g. regarding transit, document harmonization or cooperation at border crossings. Transport services, too, can be improved within regional markets. The creation of new subregional or regional connectivity hubs like ports is of great importance not only for the LDCs but also for landlocked countries. The international community should also be involved, as the LDCs and their regional partners have inadequate resources to find solutions to these problems.

D. Investment

66. Although there has been an increase in FDI flows to the LDCs, the distribution of these flows remains very uneven. There is a high concentration in few natural-resource-rich countries, mostly driven by high global demand for oil and gas. The bulk of FDI is aimed at extracting activities, especially in Africa, while in Asia there is some FDI in manufacturing and services. These trends have reinforced the commodity dependence of many LDCs. Another problem is the fact that labour intensity of FDI projects in the LDCs is low compared to that in other developing countries.

67. There is a need to attract responsible FDI in sectors that a country deems desirable. A targeted approach is the key for that. The LDCs should strive to attract the FDI that would best contribute to the development of their productive capacities. Processing, value addition and wealth retention in the LDCs should be the key criteria for FDI promotion. To increase the benefits of FDI, there also has to be an environment that fosters the establishment of business linkages between FDI and domestic firms, especially small and medium-sized enterprises (SMEs).

68. Domestic investment is crucial for development of productive capacities. As the FDI often goes to extractive activities, other sectors could sometimes only develop on the basis of domestic investment. However, a targeted approach to investment promotion could also attract FDI that can play a role in diversifying an economy. Public-private partnerships could be a vehicle for achieving that and increasing efforts should be explored to develop these partnerships. Another could be a more dynamic public investment programme. However, a strengthened domestic resource mobilization is needed for the latter to be viable.

69. Given the scale of the needs for infrastructure development in the LDCs, efforts should also be made to increase private sector participation in the provision of infrastructure. One important way to do that is to focus on the challenge of mitigating risks for foreign investors in LDCs, particularly in infrastructure. Several proposals could be made in that direction, including (a) increased funding

of multilateral risk insurance agencies which would be dedicated to covering political and non-commercial risk in LDCs; (b) sponsoring a regional risk cover agency which would focus on LDCs political risk cover and would seek the same status as a Multilateral Investment Guarantee Agency (MIGA); and (c) creating more capacity in regional development banks for providing regional risk cover.

70. These measures could be further enhanced through home-country measures that encourage outward FDI to LDCs. In this regard, OECD's Development Assistance Committee (DAC) donor countries could consider (a) providing 100 per cent or a large percentage (50–80 per cent) of tax credits, rebates or deductions (depending on which of these would have the greatest impact on influencing transnational corporation (TNC) behaviour in the donor country concerned) on equity invested by the home-country companies in LDCs against their tax liabilities in their home countries; (b) establishing and strengthening the capacity of investment promotion agencies for the attraction of responsible FDI in LDCs within bilateral aid, thus ensuring that support for FDI flows to LDCs becomes a major priority in bilateral aid; and (c) establishing a small special purpose LDC infrastructure investment fund that would provide equity and debt financing and of mobilizing domestic-currency resources for lending to infrastructure projects in LDCs.

71. In addition, some concrete ideas were discussed in relation to enterprise development in the LDCs. In particular, UNCTAD's Business Linkages Programme that connects large companies with domestic suppliers in developing countries, as well as the Empretec programme that trains and supports entrepreneurs, were mentioned as potentially very useful tools for enhancing enterprise development in the LDCs. Another proposal is the development of small-scale solar power electricity production in rural areas of the LDCs, currently implemented by a nongovernmental organization in cooperation with a TNC.

E. Technology

72. There is an urgent need to strengthen the technological capabilities of the LDCs in an increasingly open and competitive global environment. The rapid improvement that had taken place in many LDCs in terms of access of information and communication technologies (ICTs), especially mobile phones, which opens new opportunities for small and micro-enterprises to access information and to communicate, was noted. However, these examples are not easily replicable in other key technologies. Channels such as trade or FDI that have helped some countries to launch processes of accumulation and diffusion of technological knowledge were not working well for the LDCs.

73. There was a need to simultaneously address issues of technological absorptive capacity, increased exposure to and transfer of foreign technology, and endogenous knowledge accumulation. At the national level, science, technology and innovation (STI) policy should be mainstreamed into the overall development strategies of the LDCs; national policy should also consider STI issues through a holistic approach such as the one provided by the national system of innovation.

Exercises such as UNCTAD's Science, Technology and Innovation Policy (STIP) Reviews could help in this regard. The knowledge and technology dimensions should also be incorporated into international, regional and South-South development frameworks and actions. Development-oriented innovation policies should be recognized as one of the major strategic lines in the outcome of LDC-IV.

74. Transfer of technology remained an irreplaceable ingredient of the policy mix needed to improve the capacity of the LDCs to benefit from STI. While it was recognized that the policy and regulatory framework for innovation extended well beyond intellectual property issues, it was stressed that the LDCs should take full advantage of the flexibilities available to them. The need to address the inadequate level of implementation of Article 66.2 of TRIPS was highlighted. It was suggested that a more standardized reporting methodology would help identify best practices in the implementation of the commitments made by developed countries in this regard. Geographical indication has so far been an underutilized area of IPRs in the LDCs, and should be included in the agenda, as well as the possibilities to expand the traditional African design for the purposes of industrial design.

75. Ideas were exchanged about how to make transfer of technology work more effectively for the LDCs. More attention should be paid to the transfer of technology generated by public sector entities; regional and inter-regional trade agreements could be better harnessed to foster transfer of technology and innovation and regional approaches to technology and innovation could be encouraged.

76. A critical gap in access to finance for the few firms in the "missing middle" of the enterprise structure in LDCs should also be addressed. Since enterprise innovation is the backbone of successful industrial development, there is a need to provide a policy, financing and institutional framework for rectifying the weakness of the enterprise sector in LDCs in this area. The International Spark initiative proposed by UNCTAD could be a way for the international community to address these issues. It would involve the setting up of national technology/innovation funds which would be internationally financed through official aid, and/ or private foundations or sovereign wealth funds.

77. The fund should support different kinds of SMEs, including dynamic microenterprises in the informal sector. The types of innovation to be supported should cover a broad spectrum of activities: equipment modernization, technology transfer from abroad, development of local technological capabilities, introduction of new materials, imitation, backward engineering, design, engineering, learning/training, and R&D. Part of the innovation process should involve technology transfer, which has its own specific challenges, and these could also be incorporated in the initiative. For example, SMEs in industrialized countries have untapped potential for technology transfer, but they need to be offered incentives, such as a subsidy, as market prices are not enough. But technology transfer will only be effective if it is accompanied by supporting the building of technology capability in the transferee. The International Spark Initiative could provide a way of making Article 66.2 of the TRIPS Agreement work.

V. Conclusion

78. There is a widespread search for constructive and pragmatic new development paths in the LDCs. A major lesson of past experience is that focusing on the development of productive capacities is an effective way to achieve sustained economic growth, beneficial integration into the global economy and mass poverty reduction. The development of productive capacities will best be achieved in LDCs when national leadership and efforts are complemented by more effective LDC-specific international support mechanisms, which should be more geared to developing the productive capacities of LDCs, by more development-friendly global economic regimes which affect development in LDCs, and by enhanced South–South development cooperation. LDC–IV should promote action in these directions.

DEVELOPING PRODUCTIVE CAPACITIES IN LEAST DEVELOPED COUNTRIES: ISSUES FOR DISCUSSION

Pre-conference Event to LDC-IV: Building Productive Capacities in LDCs for Inclusive and Sustainable Development *Geneva, 27-29 October 2010*

UNCTAD/ALDC/2010/1, 15 October 2010

I. Recent development experience

During the period 2002–2007, least developed countries (LDCs) as a group experienced high gross domestic product (GDP) growth rates, which surpassed the 7 per cent target of the Brussels Programme of Action. However, about a quarter of the LDCs continued to experience very sluggish growth or economic regression. Moreover, even in the more successful countries, growth was associated with a pattern of insertion into the global economy based on commodity exports, low-skill manufactures and tourism, which meant that they were highly vulnerable to external shocks. Omitting oil-exporting countries, there was little improvement in domestic investment and savings, and very slow technological progress in the LDCs. Agricultural productivity growth lagged and there was widespread de-industrialization rather than a progressive structural transformation. Most significantly, the form of economic growth was not associated with broad-based improvements in human well-being, but rather very slow poverty reduction.

In 2008 and 2009, there was a sharp though very heterogeneous slowdown in growth in the LDCs. The LDCs did not fare as badly as other developing countries, partly because commodity prices recovered in 2009 and partly because multilateral institutions provided increasing official flows. But it has been estimated that the number of people living in extreme poverty was 7.3 million more than it would have been without the crisis in 2009 (Karshenas, 2009). More significantly, about half the population of the LDCs still lives in extreme poverty and the long-standing structural weaknesses and vulnerabilities which contribute to the LDCs' continued marginalization in the global economy remain.

II. The key policy challenge

Many LDCs are now at a critical moment in which they face a double challenge.

Firstly, they must find productive jobs and livelihoods for the millions of young people who are entering the labour force each year.

The scale of this employment challenge is formidable. In Mali, for example, it has been estimated that the number of new entrants to the labour force were 171,800 in 2005 and they will increase to a peak of 447,800 per annum in 2045, when the

annual additional labour force will start to decline. In Madagascar, the new entrants to the labour force in 2005 are estimated as 286,200 and their number will increase to 473,400 per annum by 2035, when the additional labour force will begin to decline.

Moreover, the nature of the employment challenge is changing. In the past, most of the new labour force was absorbed in low-productivity livelihoods in agriculture. But farm sizes are diminishing and farmers are being forced to cultivate more ecologically fragile land. The failure to improve agricultural productivity means that agricultural livelihoods are pitifully poor as well as physically onerous and full of drudgery. Thus, more and more people are seeking work outside agriculture and urbanization is accelerating. But LDCs have not been able to increase agricultural productivity significantly, nor to generate productive jobs and livelihoods outside agriculture. The number of survivalist informal economic activities in urban areas has been multiplying.

Secondly, the LDCs must deal with the employment challenge in an open-economy context. Very few LDCs have restrictive trade regimes at present, and most have undertaken rapid and extensive trade liberalization. But their existing production and trade structures offer very limited opportunities in a rapidly globalizing world driven by new knowledge-intensive products and services with demanding conditions of market entry. At the same time, rapid opening up in more traditional sectors is exposing existing producers to an unprecedented degree of global competition. Benefiting from recent technological advances requires advancing towards and crossing various thresholds in human capital, research and development (R&D) and management practice, which most LDC economies have lacked the resources to do. The relentless logic of cumulative causation strongly threatens to push LDCs even further behind, and LDCs will also face new challenges associated with climate change.

The recent food, fuel and financial crises have highlighted the economic vulnerability of the LDCs. The global financial and economic crisis must be seized as an opportunity for moving beyond business as usual.

III. Productive capacities as the basis for a paradigm shift

There is a widespread search for pragmatic and constructive policies which can foster new, more inclusive development paths in LDCs. UNCTAD has argued in successive LDC Reports that the key to achieving sustained development and poverty reduction in the LDCs is to put the development of productive capacities – and the related expansion of productive employment – at the heart of national and international policies.

The term “development of productive capacities” is understood by different people in different ways. From the UNCTAD perspective, it does not refer to the expansion of export supply capacities or to technical assistance which is oriented to improve entrepreneurial capabilities, though both of these elements are usually part of the

process. Rather, the development of productive capacities refers to the expansion of productive resources, acquisition of technological capabilities and creation of production linkages which permit a country to produce an expanding array of goods and services and enable a beneficial integration into the global economy on the basis of an internal momentum of growth development.

From the UNCTAD perspective, the development of productive capacities occurs through three inter-related processes — capital accumulation, technological progress and structural change. Capital accumulation and technological progress not only lead to the expansion of existing productive potential. They facilitate a process of diversification away from sectors characterized by diminishing returns towards sectors characterized by increasing returns, as well as a shift in the form of integration of LDCs with the global economy. Substantial poverty reduction occurs as employment opportunities increase along with the transformation of the productive base of the economy. The ways in which productive capacities are developed are also critical for ensuring sustainable development and the emergence of a low-carbon trajectory.

In line with the principle of policy diversity, given the variety of the LDCs, heterogeneity of market conditions among countries at different levels of economic development, as well as structural global asymmetries, the shift to a productive-capacities-led policy approach will have to be flexible and take into account differences in development and income levels, economic structures and factor endowments. But focusing on building productive capacities will require a paradigm shift with respect to current national and international policies — a different approach to poverty reduction, to the role of the state, and to international trade, finance and technology.

IV. The nature of the paradigm shift

A. The approach to poverty reduction

The paradigm shift advocated here places production and employment at the heart of efforts to reduce poverty. This does not mean that social sector spending and human development targets are unimportant. Indeed, health, education and social welfare should be seen as part of the process of developing productive capacities. However, it goes beyond this. It links sustained and substantial poverty reduction to the development of productive base of a society. The capacity to consume of a society is related to its capacity to produce. Employment expansion is at the heart of poverty reduction.

B. The role of the State

The idea of developing productive capacities is not absent from the current policy approach. At present, emphasis is being placed on improving the overall investment climate, in particular through the reduction of bureaucratic red-tape and governance-

related costs of doing business. But whilst this is important, it is insufficient in an LDC context characterized by extensive structural weaknesses. The paradigm shift advocated here involves a different approach to the development of productive capacities. There is a need for a more pro-active approach to developing productive capacities which will require the state playing a more developmental role and a better balance between markets and the state. Empowering national leadership in the design and implementation of national development strategies, and policy space for pragmatic experimentation are vital issues.

C. The new approach to international trade, finance and technology.

The paradigm shift advocated here also involves a different approach to international trade, finance and technology.

Since the early 1980s, there has been a strong tendency for ideas from international trade theory to dominate understanding of development processes. This occurred initially through comparisons between the relative success of “outward-oriented” and “inward-oriented” development strategies, which were associated with particular trade policy regimes. But it was reinforced during the 1990s through arguments that fast and full integration with the world economy was the key to seizing the opportunities of globalization and minimizing the chance of being left behind. From this perspective, global integration began to substitute for national development as the major policy objective of Governments.

Recent experience shows that this is much too simplistic and indeed the most successful developing countries have not followed the orthodox policy prescription. In the approach advocated here, international trade is seen as essential for the development of productive capacities, and the development of productive capacities is seen as essential for international trade. But the paradigm shift entails starting at the development end, rather than the trade end, of the relationship between trade and development. National and international policies which can facilitate this must be rooted in a development-driven approach to trade rather than a trade-driven approach to development. The policy approach advocated here thus focuses first on production, and then from this perspective identifies how international trade can support capital accumulation, technological change, structural change, employment creation and poverty reduction. What matters is not to maximize trade, but to maximize these beneficial effects of trade. Issues related to changing the form of trade integration (via increased domestic value-added, upgrading or diversification) are central.

With regard to finance, aid inflows to LDCs increased significantly in the 2000s. But the long-term shift in the composition of aid away from production sectors and towards social sectors has been reinforced in recent years. Due to low levels of domestic resource mobilization, LDCs also remain in conditions of unhealthy aid dependency, which is undermining the possibility of genuine ownership of national development strategies. Changes in the aid architecture are thus important as well as a broader approach to development finance in which aid works to

leverage other forms of development finance. More fundamentally, the productive capacities approach gives greater emphasis to domestic resource mobilization and the promotion of investment, both domestic and foreign. Using aid to end, rather than reinforce, aid dependence is an important objective.

With regard to technology, it is clear that the building of science, technology and innovation (STI) capacity in the LDCs is a prerequisite for structural change and long-term economic growth and poverty reduction. Applications of science and technology have also become central in facilitating the achievement of international development goals related to poverty reduction, health, education and the environment. Indeed, technology has become the dividing line between development and underdevelopment, and LDCs lag far behind in their technological capacities. Changes in the international knowledge architecture are necessary to foster technology transfer, and national policies must also be adjusted to promote effective absorption and diffusion of technologies in LDCs.

V. Key general issues for discussion

The pre-event will examine what the focus on developing productive capacities means for firstly, the design of national policies to promote development and poverty reduction in LDCs and secondly, international support measures for LDCs by their development partners.

Issue One: What is the role of the State in the development of productive capacities? How to build capable developmental States in the LDCs?

UNCTAD has argued that developing productive capacities necessarily entails a more developmental role for the State. It has advocated a mixed economy model in which the government harnesses the profit motive of the private sector towards the achievement of national development objectives. This requires:

- Macroeconomic policies oriented to promote growth, investment and employment;
- A developmental agricultural policy and a developmental industrial policy to promote productive development in sectors;
- A strategic trade policy which uses available flexibilities to promote diversification and value-addition;
- An active approach to promoting firm-level entrepreneurial capabilities and innovation to create new activities.

Issue Two: What international support measures can effectively promote the development of productive capacities?

At the Third United Nations Conference on the Least Developed Countries (LDC-III) in Brussels, the major innovative idea was the Everything But Arms Initiative of the European Union (EU). A basic aim of the pre-event will be to contribute to building political consensus and analytical basis for thinking about a new generation of international support measures for LDCs. Such measures should

dovetail with national policies and work more effectively to achieve sustained growth, productive employment generation and poverty reduction. What new initiatives are possible for LDC-IV? Is it possible to move away from an exclusive reliance on market access preference-based support measures and to work towards a new set of measures which focus on the development of productive capacities?

These initiatives could involve forms of technical and financial assistance which improve national policies, as well as various forms of South–South development cooperation and new global initiatives.

VI. Concrete actionable initiatives

Possible initiatives here could include:

- International financing of national technology funds to promote enterprise innovation in LDCs;
- Periodic forums under the auspice of the United Nations in which LDCs meet and exchange experience on aid and debt management;
- Incentives for public-private partnerships to support private investment, including foreign direct investment (FDI), in infrastructure in LDCs;
- A regional approach to infrastructure development based on spatial development corridors;
- Mechanisms which can increase the developmental impact of Southern FDI; and
- Making preferential market access for the exports from LDCs commercially meaningful and beneficial for development of productive capacities.

A. International financing of national technology funds to promote enterprise innovation in LDCs — the Spark Initiative

In the last 10 years, the focus on increasing access to finance in LDCs has been on microcredit and deepening capital markets. This has addressed the problem of financing of microenterprises and large enterprises. However, there is a critical gap in access to finance for the few firms in the “missing middle” of the enterprise structure. Since enterprise innovation is the backbone of successful industrial development, there is a need to provide a policy, financing and institutional framework for rectifying the weakness of the enterprise sector in LDCs in this area. The International Spark initiative could be a way for the international community to address these issues. It would involve the setting up of national technology/innovation funds which would be internationally financed through official aid, and/or private foundations or sovereign wealth funds.

The fund should support different kinds of small and medium-sized enterprises (SMEs), including dynamic microenterprises in the informal sector. The types of innovation to be supported should cover a broad spectrum of activities: equipment modernization, technology transfer from abroad, development of local technological

capabilities, introduction of new materials, imitation, backward engineering, design, engineering, learning/training, and R&D. However, given the weaknesses of the private sector in LDCs, it is important that the financing mechanism be designed for bundling with various business development services. Part of the innovation process may involve technology transfer, which has its own specific challenges, and these could also be incorporated in the initiative. For example, SMEs in industrialized countries have untapped potential for technology transfer, but they need to be offered incentives, such as a subsidy, as market prices are not enough. But technology transfer will only be effective if it is accompanied by supporting the building of technology capability in the transferee. In general the International Spark Initiative could provide a way of making Article 66.2 of the Trade-Related Aspects of Intellectual Property Rights (TRIPs) Agreement, which obliges developed countries to provide incentives to enterprises and institutions in their territories for the purpose of promoting and encouraging technology transfer to LDCs, work.

B. Periodic forums under the auspice of the United Nations in which LDCs meet and exchange experience on aid and debt management

One important obstacle to a more development-oriented economic model in LDCs is a low national ownership of development strategy. In general, the latter has been a product of policy advices of international financial institutions through Poverty Reduction Strategy Papers (PRSPs) and official development assistance (ODA) donors' conditionalities. There is thus a constant tension between the promotion of country ownership and the desire of the international financial institutions (IFIs) and the bilateral donors to ensure that their assistance is being used to support what they regard as credible development strategy.

Country ownership of national development strategies is the cornerstone of development effectiveness and also aid effectiveness. One step that can be taken to increase country ownership is the adoption of an aid management policy in LDCs. This can play an important role in reducing the multiple ways in which aid delivery is undermining ownership by being unaccounted, off-budget, off-plan and misaligned. An aid management policy differs from a national development strategy. The latter identifies goals, objectives and targets, and the actions needed to achieve them, whereas the former should ensure that assistance received is of such a type, and is so deployed, as to maximize its contribution to the priorities set out in the country's development strategy. In this way, development strategies would no longer be devised with a view to seeking aid, but instead they would focus on LDCs' strategic interests and national needs as identified by their own policymakers.

One possible international support mechanism for the LDCs would be an international forum under the auspices of the United Nations, in which they could periodically share their experiences with aid and debt management policies. Such a forum could build on existing work by UNCTAD and the United Nations Development Programme (UNDP) on debt management. This would help them

draw up best practices building on the pioneering experiences of countries such as Uganda and the United Republic of Tanzania, which have already adopted such policies.

C. Incentives for public–private partnerships to support private investment, including FDI, in infrastructure in LDCs

Given the scale of the needs for infrastructure development in the LDCs, efforts should also be made to increase private sector participation in the provision of infrastructure. One way to do that is to focus on the challenge of mitigating risks for foreign investors in LDCs, particularly in infrastructure. Several proposals could be made in that direction:

- Increase funding of multilateral risk insurance agencies such as Multilateral Investment Guarantee Agency (MIGA) for the creation of a special purpose capital or guarantee pool by like-minded donors which would be dedicated to covering political and non-commercial risk in LDCs;
- Sponsor a regional risk cover agency or create institutional capacity at the EU level which would focus on LDCs political risk cover and would seek the same status as MIGA;
- Create more capacity in regional development banks for providing regional risk cover;
- Increase the non-commercial risk insurance capacity of bilateral export credit agencies and official bilateral insurers through specific funding and subsidies to cover a wider range of non-commercial risks in LDCs;
- Provide project-related subsidies to cover the premium costs of political risk insurance and non-commercial risk insurance for specific projects being undertaken by Organization for Economic Cooperation and Development (OECD) source countries or eligible developing-country firms in LDCs; and
- Establish credit enhancement arrangements for mobilizing available domestic funding — in developing countries in general but also, particularly, in LDCs.

These measures could be further enhanced through home-country measures that encourage outward FDI to LDCs. In this regard, Development Assistance Committee (DAC) donor countries could consider:

- Providing full (100 per cent) or a large percentage (50–80 per cent) of tax credits, rebates or deductions (depending on which of these would have the greatest impact on influencing TNC behaviour in the donor country concerned) on equity invested by the home-country companies in LDCs against their tax liabilities in their home countries;
- Establishing special-purpose investment promotion departments for FDI in LDCs (with commensurate budgets) within bilateral aid or investment agencies, thus ensuring that support for FDI flows to LDCs becomes a major priority in bilateral aid;

- Exploring the possibility of establishing a small special-purpose LDC infrastructure investment fund that would provide equity and debt financing and of mobilizing domestic-currency resources for lending to infrastructure projects in LDCs.

If such measures were to be implemented to attract private capital inflows for infrastructure development, it would be important to ensure that their spillover effects (such as technology and skills transfer) also benefit domestic investors.

D. A regional approach to infrastructure development based on spatial development corridors

To bring down trade costs, LDCs have to invest in upgrading infrastructure and in trade facilitation reform. The LDCs' public sectors, however, lack the funds to support such investments and have insufficient institutional and human capacity to conduct such reforms. By working with private stakeholders, governments of developing countries can leverage capital for investments in infrastructure and promote improved and coordinated infrastructure planning. The economic viability of private investment is often limited by low traffic volume and long investment recovery periods, however. Development aid combined with public-private partnerships (PPPs) could provide a viable means to (a) fill the financing gap, (b) reduce the risk associated with the investment and (c) provide know-how or skills that might be new to government agencies and would require the allocation of extra resources and time.

The effectiveness of infrastructure investment and trade facilitation reforms multiplies when projects are planned as part of a cross-border or regional initiative. The development of transport corridors provides an example where public and private investment and joint efforts are focused on improving commonly identified trade facilitation and transportation bottlenecks across national borders. Developing cross-border infrastructure would strengthen regional integration initiatives. Building transnational structures such as roads, railways, waterways, air transport links, telecoms and energy supply lines (development corridors) has an even stronger impact on the development of productive capacities of neighbouring countries if it is accompanied by local development projects in different sectors (e.g. agriculture and industry).

One example of this combination of projects is the Spatial Development Initiatives (SDIs) launched by South Africa. Its main project is the Maputo Development Corridor involving the Maputo Corridor Toll road, the railway from Ressano Garcia to Maputo and the Maputo Port and Harbour, as well as projects in agriculture, mining and tourism. The New Partnership for Africa's Development (NEPAD) also plans to help establish Pan-African corridors and networks. Since these are large-scale and long-term projects, their financing requires a combination of funding from national budgets, donors (from the North and South) and regional and multilateral financing institutions.

E. Mechanisms which can increase the developmental impact of Southern FDI

FDI flows from developing countries to LDCs can provide a number of development benefits, but these positive effects are not automatic; they generally require a number of policy actions. For example, governments of developing countries that invest in LDCs should strongly encourage their firms to adopt mechanisms that promote the development of productive capacities in LDCs. The home-country governments can directly influence their outward investors, especially if these are State-owned companies, financed by official institutions or sovereign funds.

Home-country governments can also adopt policy measures to influence the behaviour of their private firms dealing with LDCs. They can grant preferences (e.g. financial and fiscal incentives) to enterprises investing in LDCs to promote development through their FDI, for example by creating more domestic linkages in the host LDC economies, effectively transferring knowledge to LDC firms, developing innovative activities and generating more fiscal revenues for the host countries.

Many of the conditions and objectives that determine the development impact of FDI are contained in agreements between foreign investors and host-country governments. In addition to the fair appropriation of natural resource rents by national agents, several other measures for improving the development impact of FDI can be included in LDC host-country legislation or in the terms of agreements between the recipient LDC governments and investors. The following are examples of such measures:

- Requiring TNCs from developing countries to provide training and knowledge transfer to their local employees, as well as subcontracting farms and firms with which they establish backward linkages;
- Modalities that result in a greater development impact of FDI on LDC agriculture;
- Targets for sourcing a certain proportion of inputs domestically;
- Targets for introducing a level of processing of raw materials in the host country, where this is technically feasible; and
- Conducting some R&D activities in the LDC host country.

LDC host-country Governments should formulate an FDI policy that provides incentives for foreign investment in sectors and areas that would help resolve supply and delivery bottlenecks as well as structural deficiencies in their countries. These policies and objectives should be reflected in the terms of establishment negotiated with the foreign direct investors. Multilateral and regional financing institutions can also facilitate FDI from developing countries, which is conducive to LDCs' long-term development and diversification. Such institutions should favour those sectors or investment projects that are the most likely to foster local employment creation, transfer of knowledge and the building of linkages with the domestic economy.

F. Making preferential market access for the exports from LDCs commercially meaningful and beneficial for development of productive capacities

Product coverage and Rules of Origin (RoO) are two major issues regarding preferential market access of LDCs. In the United States, African Growth and Opportunity Act (AGOA) benefits for sub-Saharan Africa are significant for those receiving apparel benefits because preferential margin is large and existing preferences are fully used by eligible exporters. In contrast, Asian LDCs trading under normal General System of Preferences (GSP) scheme do not enjoy similar preferences. This implies scope for improvement by extending product coverage for Asian LDCs. Rules of origin, for their part, have been identified as one of the main obstacles for full utilization of the preferential market access. Therefore, rules of origin for LDCs' exports should be liberalized, simplified and made more transparent in accordance with the Hong Kong (China) Declaration.

In addition, new, innovative ways to make preferential market access for the exports from LDCs commercially meaningful should be explored. For example, developed countries could encourage their domestic firms through the provision of favourable tax treatment or grant support for partial cost-coverage to develop supply sources in the LDCs. This would enable the LDCs to take advantage of the preferential market access they have been offered but are at present unable to exploit due to their insufficient supply-side capacity. Another possibility is to encourage developing-country investors to invest in LDCs to take advantage of LDCs' preferential market access. This form of South-South cooperation could strengthen development in both LDCs and other developing countries. Duty-free quota-free initiatives could also be linked with support measures aimed at building productive capacities, facilitating integration into supply chains, promoting trade and competitiveness in beneficiary LDCs such as Aid for Trade.

VII. Outputs from the event

The discussion within the event should provide two types of output. Firstly, recommendations on the type of language which might go into a New Programme of Action for LDCs. Secondly – and perhaps most important – a set of proposals for deliverables (concrete actionable initiatives) which would support the development of productive capacities in the LDCs and could constitute part of a new set of LDC-specific international support mechanisms. The six possible international support initiatives for LDCs listed above are meant to be catalytic rather than exclusive.

UNCTAD'S CONTRIBUTION TO THE PREPARATORY PROCESS OF AND TO THE FOURTH UNITED NATIONS CONFERENCE ON THE LEAST DEVELOPED COUNTRIES, 2011

Proposals stemming from the International High-level Meeting of Experts on Sustainable Tourism for Development in the Least Developed Countries

Caen, France, 12–14 October 2010

Trade and Development Board
Fifty-first executive session
Geneva, 29–30 November 2010
Item 2 (c) of the provisional agenda

UNCTAD event in the context of the preparatory process of UNLDC-IV¹

I. Sustainable tourism

1. The growing importance of tourism-related activity has been a prominent feature of economic specialization among least developed countries (LDCs) over the past decade. The sector is now the first or second source of gross export earnings in 20 LDCs, and demonstrates fairly steady growth in at least 10 others. A related, notable change is that sustainable tourism development has become an important development objective, if not a priority, in a majority of these States. Tourism has been the main engine of socio-economic progress for many LDCs.

2. National stakeholders increasingly recognize the capacity of sustainable tourism development to reduce poverty – first through employment creation in the tourism industry, and secondly through the wealth of economic opportunities that arises from linkages with local suppliers of goods and services. Equally important is the catalytic impact of sustainable tourism development on the wider economy. The elements of progress which tourism development implies, notably in human capabilities and infrastructure, are foreseen as factors of wider structural transformation and, in some cases, of convergence with more advanced economies. It is also recognized that utmost attention should be given, from the early stages of development of the sector, to the paramount goal of sustainability, notably with regard to the preservation of cultural and environmental assets.

II. Suggestions

3. Participants made the following suggestions for the consideration of LDCs at the national level and their development partners at the international level, in their actions to promote sustainable tourism development.

¹ This document was submitted on the above-mentioned date because the meeting on which its proposals were based concluded on 14 October 2010.

A. At the national level

1. Create a safe and stable enabling environment to encourage sustainable tourism development. Encourage investment by relevant domestic and international stakeholders, including investors and suppliers of goods and services, in the wider tourism economy;
2. Mainstream sustainable tourism development as an important poverty reduction avenue in all national development strategy documents, and recognize the critical role which local authorities and communities, as well as other stakeholders at the local level, can play in supporting sustainable tourism development initiatives to enable them to fully benefit from tourism development;
3. Harness product specialization and branding to strengthen market position of LDC tourism destinations in light of the evolving international, subregional and domestic demand for tourism services. Pay more attention to the preservation of environmental assets and of natural and cultural, both tangible and intangible, heritages, including through the adoption of legal frameworks at the early stage of product development. Build productive capacities relating to these assets for product differentiation, quality and attractiveness;
4. Promote domestic tourism to support the viability of the local tourism industry;
5. Promote decent work and respect the rights of the individual in the wider tourism sector with an emphasis on the most vulnerable groups, i.e. women, youth, children and migrants;
6. Adopt and implement investment, tourism and trade policies that support national strategies for sustainable tourism development;
7. Strengthen linkages and create synergies between tourism and other economic, environmental and cultural sectors for poverty reduction, including through creating opportunities for small and local suppliers of goods and services, and through establishing a process of dialogue among all national stakeholders;
8. Develop national mechanisms to support tourism enterprise viability and competitiveness, including the access to finance, development of small and medium-sized enterprises, and access to global information and distribution systems;
9. Design and implement strategies, as an integral part of sustainable tourism development, to enhance the efficiency of various means of transport, including through cost reduction and taking into account social, economic and ecological considerations to, inter alia, make tourism sites more easily accessible;
10. Enhance the human resources potential for tourism activities through improved general education, vocational training and appropriate capacity-building measures.

B. At the international level

1. Support the national initiatives of the LDCs, including those mentioned above;
2. Establish a joint cooperation mechanism between LDCs and their development partners to promote sustainable tourism in LDCs; strengthen technical and financial assistance to LDCs in the area of sustainable tourism development, particularly for infrastructure development, and also for diversification of tourism products, institutional capacity-building, human resources and skill development, tourism enterprise creation and competitiveness, and marketing of tourism products; and encourage foreign direct investment with developmental impact to the tourism industries in LDCs;
3. Explore modalities of international support for the creation of national or subregional entities that will be able to extend development services to small tourism enterprises;
4. Explore the possibility of creating an international venture capital fund or other specialized mechanisms to finance private or public investment projects in the field of tourism in LDCs;
5. Support LDCs' efforts to access knowledge and relevant and environmentally-friendly technology to protect and develop their biodiversity, cultural and natural heritages, and to mitigate and adapt the adverse impacts of climate change;
6. Encourage decentralized cooperation options through which subnational authorities in partner countries would share their experiences with LDC authorities on sustainable tourism initiatives, including through innovative partnerships such as, for instance, South–South and triangular North–South–South exchanges of best practices;
7. Encourage regional or subregional integration programmes of direct relevance to sustainable tourism development for the benefit of the LDCs. Initiate and promote cooperation and synergies among stakeholders at local and national as well as at regional and international levels;
8. Enhance collaboration among the various international organizations, including with United Nations agencies, to ensure synergy in supporting sustainable tourism development in the LDCs. UNCTAD and the World Tourism Organization are called on to work together to explore way and means to make the tourism sector more resilient vis-à-vis external shocks.

The participants wish to thank the Government of France and the Regional Council of Basse-Normandie for their generous support and hospitality.

**INTERNATIONAL HIGH-LEVEL MEETING OF EXPERTS ON
SUSTAINABLE TOURISM FOR DEVELOPMENT IN THE LEAST
DEVELOPED COUNTRIES**

Caen, France, 12-14 October 2010

MEETING REPORT

**UNCTAD Event in the context of
the preparatory process of UNLDC-IV**

Introduction

The international meeting of high-level experts on sustainable tourism development in LDCs, held in Caen, from 12 to 14 October 2010, was one of the pre-events organized by UNCTAD in preparation for the Fourth United Nations Conference on the Least Developed Countries (LDC-IV). Organized under the aegis of UNCTAD's work on sustainable tourism development, the meeting was funded by the French Government, and was generously hosted by the Regional Council of Basse-Normandie.

The purpose of the meeting was to highlight the ability of international tourism to contribute to socio-economic progress and poverty reduction in LDCs, in the hope that the PMA-IV conference will result in new international commitments to support the development of this sector. The two immediate objectives of the meeting were: (i) to provide a group of national leaders in the tourist industry with insights that will help them in their work; and (ii) to allow for a joint discussion on how to integrate the topic in the future United Nations programme of action for LDCs.

I. Sustainable development of tourism and poverty reduction in LDCs

The economic model underlying international tourism has produced "mass" tourism. However, the sector's dynamism and prospects for significant growth raise concerns — especially in LDCs, where the natural economic, social and human environments are fragile — that must be addressed by including a sustainable element in the development of tourism, so as to promote growth in the long term while maintaining an overall balance.

The external and internal constraints weighing on the development sector, which are stronger in LDCs, must be reduced (political instability, poor infrastructure and communication systems, lack of public services, lack of funds, obstacles to the free movement of people, lack of job skills, etc.). The State has a major role to play in promoting sustainable development of tourism, especially to define a development model for the sector that is adapted to the country (to better control the "leakage" that affects the sector), in consultation with all industry players, including local communities, who are potential beneficiaries.

The tourism sector proved its resilience during the recent global economic crisis. It should continue to grow in the next 10 years: the number of international arrivals is expected to reach 1.6 billion in 2020, that is to say, double the current number.

In LDCs, particularly in Africa where the sector grew by 3 per cent per annum during the 2000s, sustainable tourism development will require a wide-reaching dialogue between public and private sectors and with local and regional actors to ensure that joint efforts are successful, particularly through intersectoral linkages that generate production and hence employment and income.

All LDCs have advantages in terms of tourism (cultural and natural heritage). Their comparative advantages allow them to place international tourism at the heart of the economic specialization that generates progress. However, they are faced with severe constraints such as insufficient local savings and the lack of a qualified national workforce, which mean that the development of the tourism economy, largely entrusted to foreign actors, is a source of "leakage" rather than national benefit. Another set of constraints that require vigilance concerns the risks of adverse effects on the natural environment and the social fabric, and even on fragile local cultures. To reduce these constraints, the State and industry players must make a joint effort to ensure that tourism revenues are equitably shared.

It is in the interest of LDCs to focus their tourism economy in specialized areas ("authentic" nature or cultural tourism), to support initiatives by groups of local entrepreneurs to adopt an institutional framework conducive to the sustainable development of the sector, and to encourage the emergence and professionalism of a class of producers of the services in question, while striking a reasonable balance between national interests and foreign interests.

The development of infrastructure and human resources, and also air transportation (without which there would be no tourism), is a key objective of LDCs with ambitions for their tourism sector, as are political stability and security.

II. The development of economic ties to reduce poverty

Leakage or loss of earnings suffered by tourist destination countries in relation to tourist activities, which can represent up to 70 per cent of potential tourism revenue, stem from the repatriation of profits and wages in the country of origin of investors and foreign labour, and from the inability to substitute local goods and services for imported goods and services.

Efforts can be made to replace the foreign inputs for domestic inputs and to strengthen the ties between tourism and other sectors of the national economy, particularly agriculture, if local agricultural products meet international standards. The development of local human resources has a key role to play in reducing the use of expatriates.

Tourism contributes to reducing poverty by creating jobs, particularly by offering many economic opportunities for local producers in the tourism sector itself, or in industries supplying goods and services related to it. The organization of local cooperatives and support for small local businesses can help achieve these objectives.

The tourism sector is labour-intensive, involving a wide range of skills, and has a notable multiplier effect: a job created in the sector can generate 1.5 jobs in related sectors such as agriculture or construction. Responsible development of the sector requires a work ethic that needs to be clearly defined by LDCs.

III. Tourist specialization: objective and field action

LDCs' choice of tourist specialization raises issues concerning the appropriateness of national assets to the evolution of international tourism demand, infrastructure and human resources, without which no tourist economy can exist, and the determination of national and international actors to develop trust in a "product" or several types of tourist services.

These issues need to be addressed by appropriate national policies, which will involve decisions that can lead to structural socio-economic progress. A real economic density may develop in a tourist economy that has been intelligently specialized. Cultural assets (both tangible and intangible) allow particularly interesting specialization because they may have a key role in attracting tourism while contributing to the positive image of the country, as may the preservation of the natural environment. It is important that those in charge of cultural and natural assets in LDCs cooperate closely with the tourism industry so that all parties involved, including tourists themselves, contribute to a healthy use of fragile resources.

IV. The development of institutional capacity for sustainable tourism

The tourism industry is mainly driven by the private sector. However, the capital needed for large-scale tourism projects is rarely available in LDCs, who are forced to rely on foreign direct investment (FDI) and foreign expertise and management skills. These foreign contributions are usually essential to "launch" a competitive tourism economy and quality. For these reasons, FDI should be fostered by government action — as a facilitator — and the government must implement a suitable policy framework, with appropriate legal and fiscal measures (exemptions from customs duties on essential imports, rules to encourage investment and public-private partnerships, etc.). The government also needs to encourage local investment.

There are, however, some risks associated with FDI: the creation of a tourism enclave, connected at the international level but not at the national one; financial leaks; some social costs; and degradation of natural and cultural tourism assets by over-exploitation. To reduce these risks, the State and economic actors must ensure that a portion of the inputs come from local sources, and that exemplary partnerships (to be emulated) and innovative partnerships (with knowledge transfers to the destination country) between foreign and domestic actors are implemented.

Regional cooperation is seen as a promising way to support the development of tourism. Several LDCs have already adopted this approach. For example, the West African Economic and Monetary Union (WAEMU) has recently adopted a policy on subregional tourism development, following initiatives taken by the Indian Ocean Commission and the Association of Southeast Asian Nations (ASEAN). The benefits of regional cooperation in tourism lie in coordinating the management of shared sites, grouping operators in subregional federations, and the free movement of nationals of member States. The movement and work of cross-

border communities must be facilitated and transportation costs reduced if regional cooperation is to be successful.

V. Entering the productive sphere and remaining competitive in the tourism economy

Tourism, like any other service activity must be competitive. In a highly competitive international environment, a rich natural environment is not enough: the price and quality of the tourism product are also important, and the product must be differentiated to ward off competition. Differentiation and competitiveness can be achieved by branding, which will eventually be supported by the use of protected visual symbols.

From a financial perspective, investment in the tourism sector is generally considered a risky activity because of the difficulty of assessing a priori the viability of a sector in which large amounts of financing will be needed, while the risks of external economic and natural shocks can be numerous. Despite this risk, specialized banks (such as Proparco, 3 per cent of whose financing commitments are in the tourism sector) finance the sector using strict selection criteria in terms of social and environmental sustainability of infrastructure and local businesses.

VI. Promoting sustainable development of tourism at the local level to contribute to poverty reduction

Sustainable development of tourism in LDCs, as in other developing countries, should involve all stakeholders, including civil society, to ensure the success of local projects.

For the government, it is a matter of achieving the Millennium Development Goals by mobilizing all partners, organizing local communities, responding to new tourist demands, entering into partnerships with local craftsmen and the trade unions representing local tourism operators from target areas, and introducing a real training policy with a focus on quality aimed at protecting the environment and heritage. It is important to encourage cooperation and partnership between all stakeholders in the sector and international partners, without whom there would be no tourism.

It must also involve all local stakeholders at the decentralized level to ensure effective coordination of actions in order to avoid overlapping projects and tourism services. The provincial or local level is the appropriate level at which to organize the actors in networks that have shared goals, values and ethics: the locals are the best ambassadors for their region, and they feel valued and take more ownership of their environment when they are more involved. Regional actors can also act as "facilitators" between local communities and the private sector.

Local communities and NGOs can also promote local handicraft activities to generate added value at local level, so that local actors can benefit directly from the local tourism industry.

Conclusion

The meeting in Caen was a success, attended by 68 participants including 39 representatives of member States (including 25 representatives of LDCs). Seven agencies of the United Nations system were represented by 18 people, which ensured good inter-agency cohesion on the theme of sustainable tourism. Avenues for future cooperation were discussed with representatives of the Basse-Normandie region and the French Ministry of Foreign and European Affairs. Finally, 18 proposals were made by participants for a tourism segment of the future United Nations programme of action for LDCs for the next decade.

These 18 proposals should be used and relayed by the member States in the preparations for the Fourth United Nations Conference on LDCs. In this respect, the role of the Office of the High Representative of the United Nations for the Least Developed Countries, Landlocked Developing Countries and Small Island Developing States, and the role of the French Government (which will hold the presidency of the next G8-G20) will be essential.

Annex 1 – Panelists

Session	Subject	Panelist
I	1	Ms. Jo Elizabeth Butler, Chair of UNCTAD's Task Force on Sustainable Tourism for Development
	2	Mr. Frédéric Pierret (UNWTO)
	3	Mr. Tesfaye Desalegne (Ministry of Culture and Tourism, Ethiopia)
	4	Mr. Gilles Bévillie (Ministère des Affaires étrangères et européennes, France)
II	5	Mr. Günter Fischer (UNCTAD)
	6	Mr. Fabrice Leclerq (ITC)
	7	Ms. Christiane Stepanek-Allen (ILO)
	8	Mr. Shafique Alam Mehdi (Ministry of Civil Aviation and Tourism, Bangladesh)
III	9	Mr. Samouth Neb (Ministry of Tourism, Cambodia)
	10	Mr. François Vellas (Université de Toulouse)
	11	Mr. Hervé Barré (UNESCO)
	12	Mr. Modibo Cissé (Ministère de l'Artisanat et du Tourisme, Mali)
IV	13	Mr. Pierre Encontre (UNCTAD)
	14	Dr. Pushkar Bajracharya (National Planning Commission, Nepal)
	15	Ms. Grace Mbabazi Aulo (Ministry of Tourism, Trade and Industry, Uganda)
	16	Mr. Rolf Traeger (UNCTAD)
	17	Mr. Diego Medina-Muñoz (University of Las Palmas de Gran Canaria)
	18	Mr. Gustave Diasso (UEMOA)
	19	Mr. Mohamed Sakho (Ministère du Tourisme et de l'Hôtellerie, Guinée)
	20	Mr. Patrick Ramonjavelo, (Ministère du Tourisme et de l'Artisanat, Madagascar)
V	21	Ms. Tamara Nanayakkara (WIPO)
	22	Ms. Virginie Bleitrach (PROPARCO, France) + Mr. Denis Sireyjol (PROPARCO, France)
	23	Ms. Lieketseng Mohasi-Selinyane (Ministry of Tourism, Environment and Culture, Lesotho)
	24	Mr. Htay Aung (Ministry of Hotels and Tourism, Myanmar)
	25	Mr. Ousseynou Dieng (Ministère de l'Artisanat, du Tourisme et des Relations avec le Secteur Privé et le Secteur Informel, Sénégal)
	26	Mr. Apan Guy Johnson (Ministère de l'Artisanat et du Tourisme, Bénin)
	27	Mr. Bartolomeu Soto (Ministry of Tourism, Mozambique)
	28	Mr. Etienne Coffin (Comité français pour le développement durable du tourisme, France)
VI	29	Mr. Mamadou Bâ, Vice-Président de la Région de Saint-Louis du Sénégal
	30	Mr. Alain Tourret, Vice-Président du Conseil Régional de Basse-Normandie
	31	Mr. Gautier Amoussou, Président d'ECO-Bénin
	32	Mr. Mohamed Mahmoud Ba ould Ne (Ministère du Commerce, de l'Artisanat et du Tourisme, Mauritanie)

Moderators

Session I: Mr. Philippe Lacoste (Ministère des Affaires étrangères et européennes, France)

Session II: Mr. Frédéric Pierret (UNWTO)

Session III: Ms. Anne Miroux (UNCTAD)

Session IV: Mr. Samouth Neb (Ministry of Tourism, Cambodia)

Session V: Mr. David Diaz-Benavides (University of Aix-Marseille III)

Session VI : Mr. Jean-Louis Laville (Director of the Tourism Regional Council)

Coordination: UNCTAD: Mr. Patrick Portes, Ms. Lisanne Losier, Ms. Sabrina Ielmoli

**PRESIDENT’S SUMMARY: KEY DEVELOPMENT
CHALLENGES FACING THE LDCS: FOLLOW-UP TO THE THIRD
UNITED NATIONS CONFERENCE ON THE LEAST DEVELOPED
COUNTRIES AND PREPARATIONS FOR THE FOURTH UNITED
NATIONS CONFERENCE ON THE LEAST DEVELOPED COUNTRIES**

UNCTAD Trade and Development Board
Forty-ninth executive session, Geneva, 8-9 June 2010
(Agenda item 2 (a))

A. Highlights of the session

1. The first day of the forty-ninth executive session of the Trade and Development Board was held on 8 June 2010 with the objectives of (a) assessing the performance of the least developed countries (LDCs) since the adoption of the Brussels Programme of Action in 2001 in areas covered by UNCTAD’s mandate, (b) determining the key development challenges facing the LDCs in the coming period and (c) looking ahead at how to promote structural transformation in LDCs. It comprised two sessions — one high-level segment and one round table. In the high-level segment, the Secretary-General of UNCTAD made the inaugural intervention, followed by statements from the Ambassador of Nepal (Coordinator of the LDC Group), the Ambassador of Turkey (representing the host country of Fourth United Nations Conference on the Least Developed Countries (LDC-IV)) and the representative of the United Nations Office of the High Representative for the Least Developed Countries, Landlocked Developing Countries and Small Island Developing States (OHRLLS). The key speakers at the round table were the Ambassadors of Lesotho and Zambia, and experts from the Overseas Development Institute (ODI) of London, and the Centre for Global Development (CGD) of Washington, DC. Representatives of different country groups and a large number of country delegations made statements and interactive interventions in both the sessions. The sessions were chaired by the President of the Trade and Development Board.

2. The session considered the document “In Quest of Structural Progress: Revisiting the Performance of the Least Developed Countries” (TD/B/EX(49)/2, TD/B/EX(49)/2/Corr.1 and 2). The document, an abridged version of the report of UNCTAD’s Inter-divisional Task Force on LDC-IV, provided an evidence-based retrospective analysis of the performance of the LDCs during the previous decade with a view to generate a collaborative development vision for an accelerated structural transformation of the LDCs. Endorsing the findings presented in the document, the speakers appreciated UNCTAD’s systematic contributions in providing substantive inputs, in areas of its competence, to the preparation of LDC-IV. They noted in particular the scheduling of a pre-LDC-IV event to discuss productive capacities in LDCs (27-29 October 2010) and the fifty-first executive

session of the Trade and Development Board to discuss the role of international support mechanisms (29-30 November 2010).

3. Reflecting on the recent performance of the LDCs, it was observed that, until the successive crises hit them, those countries had experienced relatively high economic growth, certain improvements in macroeconomic indicators, trade expansion with both developed and developing countries, enhanced foreign investment inflows, higher off-take of foreign aid and advances in physical infrastructural and telecommunication connectivity. However, these high overall growth rates were also characterized by highly skewed and fragile intra-group performance.

4. It was pointed out that, although the LDCs faced a set of common structural handicaps, they were increasingly becoming heterogeneous. The nature of their growth, coupled with their geophysical attributes, had led to their varying specialization, dominated by greater dependence on traditional commodity export and, in some cases, on tourism and a narrow basket of manufactured goods (e.g. textiles).

5. It was noted that the growth process in the LDCs, which was largely externally propelled, did not precipitate any progressive changes in the composition of gross domestic product (GDP), diversification of exports, reduction in commodity dependence, broad-based investment flow, substantial strengthening of trade-related infrastructure, and development of science, technological and innovation capability. Development of agriculture and food security remained one of the neglected areas of investment and policy attention. Most of the LDCs remained far from achieving the Millennium Development Goals (MDGs) and graduation from the LDC Group.

6. It was regretted that the improved macroeconomic position of the LDCs had not led to allocation of resources to the productive sectors conducive to more sustained economic growth. The limited deployment of strategic tools relating to trade and industrial policies inhibited channelling of resources to productive capacity-building that would have facilitated structural change of the LDC economies. Flows of foreign direct investment (FDI) remained concentrated in a few extractive industries, particularly petroleum. Official development assistance (ODA) also shied away from financing a productive base in the LDCs, including infrastructure and manufacturing. Indeed, investment in agriculture was also inadequate for greater value addition in the sector. Due to these handicaps, the governments in these countries were usually inhibited from effectively utilizing the policy space notionally available to them.

7. Emphasizing the need for revisiting the conventional development strategies, it was underscored that innovative strategic approaches had to be adopted in the future to make more effective contributions towards fostering structural transformation of LDC economies. In that connection, it was maintained that the strategic policy-oriented role of the developmental state had to be strengthened to create a domestic industrial base and business development services. The

traditional approach towards macroeconomic adjustment had to be redefined to enable sustained and inclusive growth.

8. The session underscored the changed global and regional context within which the LDCs now had to deal with their national development challenges. Elements of that new context presented for the LDCs both opportunities (e.g. the rise of the global South) and threats (e.g. adverse implications of climate change). The emerging context had also been underpinned by the aftermath of the global economic and financial crisis, including the recent initiatives in the areas of recovery of global growth and reform of global economic governance.

9. The opinion was expressed that the role of the LDCs needed to be enhanced in global economic governance so as to reflect their interests more substantively on systemic issues, particularly relating to trade, investment and development finance.

10. There was a general consensus that the outcomes of LDC-IV should herald a departure from the “business as usual” approach towards addressing the development challenges of this group of countries. The outcome of the LDC-IV should be smart and strategic in its approach, with specific measurable targets supported by adequate resources. The outcome should be integrated with other ongoing international development initiatives in favour of the LDCs, including the MDGs, the Paris Declaration on Aid Effectiveness, and the Enhanced Integrated Framework (EIF).

11. The participants were categorical in their expectation to have in place a more effective follow-up and monitoring mechanism of the internationally agreed targets for the LDCs. It was further pointed out that – for a more objective assessment of the efficacy of the performance of the LDCs, as well as that of the international support measures adopted in their favour – there was an urgent need to strengthen the relevant information and database.

B. Major issues discussed at the session

12. The point that was most frequently emphasized during the session was that, during the decade following the adoption of the Brussels Programme of Action, the fundamental conditions of the LDCs had not changed much. Although there had been overall gains in the aggregate, those of LDCs as a group had been limited to a handful of countries, mostly experiencing temporary booms due to high commodity prices. In fact, even those countries were confronting serious problems due to increased price volatility in the international markets. The vulnerabilities of the LDCs to exogenous shocks were most tragically demonstrated by the recent earthquakes in Haiti.

13. It was further argued by some that most of the problems of the LDCs were well known, and thus the emphasis should be on steadfast actions. However, it was generally contended that, in the backdrop of the disappointing development experience and given the new challenges, there was a need for articulating innovative

ideas to chart a new development path for inclusive and participatory growth for the LDCs leading to structural transformation of their economies. The importance of commitment on the part of leadership was emphasized in that respect.

14. Reflecting on the nature of the growth in LDCs, it was observed that there was a need to rebalance and diversify the sources of growth through incremental domestic demand. The other structural factors inhibiting sustainable growth in these countries were low productivity, lack of competitiveness, unfavourable business environment, underdeveloped infrastructural services, limited private entrepreneurship and lack of skilled human resources. Accordingly, the need for transformative growth had become important more than ever.

15. The need for structural transformation of the LDC economies was the common thread of almost all interventions. The central point in that regard was the challenge of creating a developmental State that could take policy initiatives and make institutional interventions to create new competitive advantages for the LDCs. The participants highlighted that the envisaged strategic developmental role of the State entailed the formulation and implementation of targeted engagements for enhancing productive capacity, productivity, diversification and value addition.

16. The need to prioritize agricultural development was a consensus view. Many participants regretted the neglect of agriculture in investment decisions and underscored the need to channel more resources to that sector for a number of fundamental reasons, including employment and income generation for the poor, ensuring food security at the national and household level, and promoting diversification of value addition to exportables. That need was further accentuated by the fact that an increasing number of LDCs were experiencing rapidly rising deficits in food products.

17. A significant number of interventions highlighted the critical importance of diversification and specialization of LDCs' exports. The basis of sustained diversification and specialization was considered to be compositional change of the GDP in favour of manufacturing and/or the modern service sector. However, the need for having more tradable products and reduction of dependence on a couple of export markets was also deemed necessary. It was further underscored that LDCs should develop their exports in services, particularly through high-value tourism and temporary movement of natural persons as service providers. Delegates were, however, alerted to the fact that the tourism industry often necessitated a considerable amount of imports, reducing the net foreign exchange earning potential of the industry.

18. Many participants recalled that structural adjustment programmes and across-the-board liberalization had affected the food and manufacturing sectors badly, and urged that caution be exercised in the future with respect to new trade liberalization obligations.

19. The problems of entrenched commodity dependence of a large number of LDCs received special attention during the discussion. The major emphasis was on developing backward and forward linkages of the commodity sector in the national

economy. The food-processing sector was singled out as having the most potential in that regard. The macroeconomic challenges of dealing with the boom-and-bust cycle of commodity prices were also discussed. Sudden upward-moving price shocks could appreciate the currency of the commodity-exporting country, making all other exports lose competitiveness.

20. Some participants pointed out the important role that a wide range of informal sector activities played in providing employment and income to the poor in LDCs.

21. The concern about the lack of breadth in the industrial development of LDCs was reflected in the discussion on FDI. It was noted that, despite the rapid increase in FDI flows to LDCs up to the onset of the economic crisis, they were mostly concentrated in the extraction of natural resources, in particular petroleum. Several participants noted the limited opportunity for linkage creation associated with extractive industries. Agriculture, food processing, telecommunications and tourism were mentioned by the participants as promising sectors which could attract FDI.

22. There was broad agreement that a substantial amount of investment was necessary in LDCs to develop infrastructure, such as transport and telecommunications, in order to make industrial diversification possible. The paramount necessity to develop the energy sector was also mentioned.

23. The participants maintained that access to technology was an important development component complementary to trade and financial factors. Technology and know-how were critical to enabling a diversification of LDC economies. Raising the level of science, technology and knowledge capacities was also important in order to reduce vulnerabilities of LDC to natural disasters and mitigate climate change. It was noted that, to put this into practice, leadership, development governance and an enabling environment were required.

24. The role of South–South cooperation in facilitating structural transformation in LDCs was widely discussed. It was mentioned that LDC exports to the South were currently almost equal to those going to Organization for Economic Cooperation and Development (OECD) countries, although the South was essentially importing primary commodities from LDCs. In that context, it was noted that certain developing countries had initiated duty-free quota-free preference schemes for LDCs. FDI from the South was also increasing, and it had shown more resilience during the crisis. The South could be a major source of transfer of technology and know-how. Regional integration based on better connectivity was also emphasized in that connection.

25. The growing diversity of the LDC Group came up for discussion a number of times. For example, it was pointed out that some were landlocked while some others were island States. LDCs varied quite a bit in terms of resource endowments, including demographic and natural resources. A number of the LDCs were post-conflict countries. All those attributes pointed to the need to address specific concerns within an integrated international support framework for the LDCs.

26. It was further pointed out that, while addressing the country level challenges, one should not miss targeting the most vulnerable sections of the LDCs. Besides the hardcore poor, the need to target women and youth was also mentioned.

27. While ODA flows to LDCs had increased perceptibly in the recent past, it fell short of commitments and the picture was not uniform across the group. As developed countries were likely to enter a phase of physical consolidation, the level of future ODA remained uncertain. As such, the issue of type and quality of aid would become more important for LDCs.

28. The session witnessed a debate on the desirable composition of disbursed foreign aid to LDCs. A large group of participants favoured more targeting of productive capacity-building, including infrastructure and manufacturing. Meanwhile, a number of participants also pointed out that, in most LDCs, social sectors remained underfinanced. As a result, they were failing to meet MDGs and failing to develop the skilled labour force necessary for diversification of the economy. Differing views were also mentioned regarding the advantages of having sectorally dedicated foreign aid as compared to budget support.

29. Issues relating to development finance, other than ODA, were also raised at the session. The role of remittances in LDCs – ranging from providing a cushion to current account balance to the government to supplying poverty alleviating income to rural households – was highlighted. It was opined that the national development finance institutions (DFIs) needed to play a more energetic role to enhance productive investment in LDCs. LDCs also needed to increasingly tap into the funds available with the regional development banks. The Group of Twenty (G20) could also design support measures for LDCs through monetary and fiscal stimuli.

30. Some participants stressed the ways in which the world had changed over the previous 10 years, with greater focus on climate change, the increasing role of South–South cooperation, and the three crises (food, fuel, and global economic and financial) being among the issues mentioned. The importance of food security was raised a few times and several of the interventions highlighted the negative impact of the crises on LDCs.

31. A number of interventions raised the issue of implications of recent crises on LDC economies. It was particularly mentioned that the LDCs were innocent victims of the recent financial and economic crisis. Adverse consequences of the crisis continued to be felt by LDCs in areas such as exports, investment, remittances, tourism income and development finance. Ways and means to build economic resilience to mitigate future shocks were also discussed.

32. The issue of the adverse impact of climate change in LDCs figured prominently in a number of interventions. It was mentioned that vulnerabilities of LDC economies had increased further due to, inter alia, climate change-induced frequent natural disasters, water stress, negative effects on crop

cultivation and fisheries, loss of habitation and the emergence of environmental refuges. Emphasizing the need to undertake climate change mitigation measures in greenhouse gas-emitting major countries, adequate finance for underwriting adaptation measures in LDCs was stressed.

33. The importance of improving developmental governance in LDCs was also highlighted by some participants. It was pointed out that issues relating to governance had become more critical over time, and systematic and sincere efforts were required to deal with inefficiency and corruption to enhance the developmental impact of scarce investible resources. As complete overnight modernization of the public administration was not possible in LDCs, it was suggested that a modest but concrete beginning could be made at a key nodal institution of economic management, e.g. finance or trade ministry, planning commission or central bank.

34. Referring to United Nations General Assembly resolution 43/178, dated 20 December 1988, entitled “Assistance to the Palestinian People”, it was recalled that there was a decision to extend to the occupied Palestinian territory the same preferential treatment accorded to the LDCs.

35. The participants were briefed about the ongoing preparations for LDC-IV. It was mentioned that the national and regional reviews of the Brussels Programme of Action were already completed. The preparatory process had four interlinked tracks: intergovernmental, parliamentary, business and non-government organizations (NGOs). Pre-conference events were being organized by a number of organizations and agencies. Informal meetings to give shape to the outcome document were to begin in New York in September 2010, and the Preparatory Committee for the Conference would meet in January and April 2011, with the conference itself expected to be held in May. The slogan of the conference was “Global Commitment to Partnership”, signifying the need to rebuild solidarity — morally and substantially — based on the enlightened self-interest of the global economy.

36. Expressing their expectations about LDC-IV, the delegates were unanimous in their view that the outcomes should provide concrete and integrated measures to address the real problems of LDCs in the changed circumstances. Most of them called upon the international development community to engage in the LDC-IV process in earnest.

C. Recommendations put forward by the participants

1. New development approach

In view of their past experiences, and taking note of the new global and regional context, the development approaches pursued in the LDCs have to be revisited and put on a more pragmatic basis.

In the efforts to promote structural transformation of their economies, the LDCs have to be supported in making greater and more effective use of developmental policy space.

In designing their national development paths, LDCs have to strengthen and operationalize the strategic and enabling role of the State in leading structural transformation of the economies.

At the same time, in designing the implementation of public policies, the State should respect the principles of transparency, accountability, equity and participation.

2. Reconsidering macroeconomic framework

The macroeconomic framework in the LDCs needs to be reconsidered, putting more emphasis on inclusive growth and employment than on exclusive preoccupation with balancing accounts.

Taking note of specific circumstances, the LDCs have to rebalance and diversify their sources of growth, promoting a greater role for domestic demand.

LDCs need to develop and deploy strategic trade and industrial policies to accelerate structural change of their economies.

3. Addressing specific vulnerabilities

While designing international support measures in favour of LDCs, the heterogeneity of the group has to be recognized and accommodated, particularly addressing the specific development needs of landlocked countries, island States, climate change-affected economies and post-conflict societies.

4. Agriculture and food security

Fostering “agri-renaissance” through higher allocation of public expenditures has to be a primary objective of LDCs for alleviating rural poverty as well as for ensuring food security.

In efforts to revitalize and develop the agricultural sector, there must be a special focus on small-scale farming.

Promoting agri-processing activities has to get greater policy attention.

New technologies have to be made available to LDCs for enhancing productivity growth in the agriculture sector, as well as to allow them to take advantage of “green growth” opportunities.

5. Trade diversification and market access

A major thrust of trade-related measures for LDCs has to be the diversification of the export basket, adding value to export items by developing backward and forward linkages, and through accessing new markets.

Sustainable tourism should be actively promoted to maximize beneficial development impacts;

LDCs should be able to use all the flexibilities provided under WTO rules to foster the development of productive capacities.

The Doha Round of WTO trade negotiations must be concluded as soon as possible, and must address the development concerns of LDCs.

An interim outcome (early harvest) from the Doha Round addressing the trade interests of the LDCs needs to be delivered. Some of the elements of such an interim LDC package may include the following provisions:

- (a) Duty-free quota-free market access by the developed countries and emerging economies for all products from all LDCs;
- (b) Doing away with all non-tariff measures affecting exports from LDCs;
- (c) Improving the Rules of Origin provisions to enhance effectiveness of preferential market access schemes;
- (d) Comprehensive and effective implementation of existing guidelines for fast-track accession of the LDCs to WTO;
- (e) Elimination of trade-distorting domestic support measures and export subsidies in cotton production;
- (f) Support for Mode 4 for promoting trade in services in the sectors where LDCs have supply capacity;
- (g) More resource commitment for Aid for Trade, particularly for broader and deeper use of the EIF facility.

MDG 8 on international partnership, which deals with trade issues, should also be used to deliver the interim package.

Participation of LDCs in bilateral trade agreements should not jeopardize their rights and entitlements under the multilateral trading system.

6. Reducing commodity dependence

Multilateral level actions have to be taken to deal with internal and external factors inhibiting reduction of singular dependence of LDCs on primarily commodities export.

Both horizontal and vertical diversification have to be pursued in commodity-dependent LDCs.

Enabling mechanisms and tools for pre-empting price volatility in commodity markets as well as for the smooth flow of commodity market information have to be operationalized.

Policy measures to counter-balance effects of private standards in commodity markets have to be instituted.

7. Investment promotion

Promotion of domestic investment that boost domestic demand as well as support

export expansion should be a fundamental policy objective in LDCs.

Both home and host country measures are to be put in place to guide FDI away from extractive industries to productive sectors in LDCs.

Inflow of FDI has to be refocused on basic infrastructure development, such as building and upgrading roads, ports, communication facilities and production of electricity.

Public policies and incentives have to be designed and implemented to promote productive association between foreign and domestic capitals with a view to promote in-country backward and forward linkages.

A synergy between private investment and ODA has to be sought, including through public–private partnership (PPP), so as to promote productive transformation of LDC economies.

Local financial institutions have to be developed by LDCs to support both domestic and foreign investors.

8. Infrastructure development

As a prerequisite for structural change, infrastructure should be given greater priority in public investment programmes.

Significant amounts of ODA have to be earmarked for infrastructure development in LDCs, desirably by creating dedicated funds.

Domestic capital and inflows of FDI have to be guided to development of physical infrastructures in LDCs.

Different forms of PPP, such as build–operate–transfer (BOT) may be more purposefully practised to expedite development of physical infrastructure.

9. Science, technology and innovation capacity-building

The national science, technology and innovation (STI) system in LDCs should receive greater public policy support.

The STI system in LDCs has to be linked to public service and business activities.

A dedicated capacity-building fund, supported by earmarked ODA, has to be created to develop national STI systems in LDCs.

To utilize the full potential of information and communications technology (ICT) and to overcome the “digital divide”, the infrastructural backbone of ICT systems in LDCs has to be developed.

10. Access to technology

There should be immediate implementation of the flexibilities and preferential

provisions related to WTO and WIPO rules on intellectual property, which promise technology transfer flows to LDCs. For example, article 66.2 of the Trade-Related Aspects of Intellectual Property Rights (TRIPS) Agreement, which requires developed countries to provide incentives to their companies that transfer technology to LDCs, has to be operationalized.

A “technology bank” may be created to facilitate transfer of technology to LDCs.

11. Official development assistance

International commitments have to be fulfilled by the development partners by providing long-term concessional aid in a predictable fashion.

The quality of the foreign aid delivered has to improve as well in line with the Paris principle of aid effectiveness.

Foreign aid must give stronger support to productive capacity-building efforts in LDCs, including financing physical infrastructure and manufacturing industries.

More predictable and additional resource availability for trade-related capacity-building, particularly for EIF, has to be ensured.

12. Other forms of development finance

Greater efforts to mobilize domestic resources in LDCs, particularly taxes, have to be undertaken to have additional resources to underwrite development expenditures.

Remittances from expatriate workers have to be more effectively utilized to spur investments.

LDCs have to have greater access to the facilities of the regional development banks.

LDCs need to explore new and innovative sources of development finance, including sovereign wealth funds.

13. South–South and triangular cooperation and regional integration

LDCs need to approach economic interactions with the emerging economies and other advanced developing countries as a vehicle for structural transformation of their economy.

The emerging economies need to, among others, provide the LDCs with improved market access without any tariff or non-tariff barriers, encourage FDI flow to productive sectors in LDCs, support transfer of own technologies to LDCs and allocate concessional development finance to underwrite structural change of LDC economies.

LDCs should fruitfully engage in triangular cooperation, involving the developed countries along with the developing countries.

Participation of LDCs in regional integration schemes has to be strengthened in order to scale up productive capacity and improve economic efficiency, particularly through greater connectivity and other trade-related measures. In this connection, participation of LDCs in numerous regional integration schemes has to be consolidated and streamlined to reduce stress on government as well as on business people and entrepreneurs.

14. Global crisis

Any specific measure undertaken as a part of stimulus and other policy packages to deal with post-global crisis circumstances in any country, but affecting the competitiveness of the LDCs, should be discontinued.

Special measures have to be designed to protect LDCs from the adverse impact of global economic and financial crises in the future.

15. Climate change

Mitigation measures have to be put in place to reduce the disproportionate effects of climate change on LDCs.

Adequate financing has to be made available for undertaking necessary adaptation measures in LDCs.

Access of LDCs to environmentally-friendly technology has to be ensured.

Removal of fossil fuel subsidies has to be encouraged.

16. Occupied Palestinian territory

Facilities and preferences to which the LDCs are entitled must be made available to the occupied Palestinian territory.

17. Information base

The informational and statistical bases pertaining to LDCs have to be significantly strengthened to help achieve an effective, reliable and informed policymaking process, a deeper understanding of the performance of LDCs, and a better assessment of the state of delivery of international commitments.

18. Representation and participation

Access, representation and participation of the LDCs have to be effectively increased in all international and regional platforms — formal and informal — so as to reflect the concerns and interests of the group. When designing approaches and measures to reform global financial architecture and other areas of economic governance, implications of such measures for economic development of the LDCs have to be taken into account.

19. LDCs and the MDGs

In the MDG review exercise, the importance of developing productive capacity and gainful employment should be fully recognized.

20. Outcomes of LDC-IV

The outcomes of LDC-IV have to be substantive with specific and prioritized targets that will promote accelerated structural transformation of the LDC economies.

The measures and targets to be set by LDC-IV have to be owned genuinely by all concerned partners and confirmed through firm resource commitments, and they should not lead to an excessive management burden for LDCs.

The developmental measures to be endorsed by LDC-IV have to be interfaced with other ongoing international processes and initiatives concerning the LDC Group.

A transparent, accountable and result-oriented mechanism has to be put in place to ensure the smooth and systematic follow-up of the implementation of the targets to be set by LDC-IV.

**FOLLOW-UP TO THE THIRD UNITED NATIONS CONFERENCE
ON THE LEAST DEVELOPED COUNTRIES (LDCS) AND
PREPARATIONS FOR THE FOURTH UNITED NATIONS
CONFERENCE ON THE LEAST DEVELOPED COUNTRIES:
KEY DEVELOPMENT CHALLENGES FACING THE LDCS¹**

**In Quest of Structural Progress:
Revisiting the Performance of the Least Developed Countries^{2**}**

TD/B/EX(49)/2. 12 May 2010

Trade and Development Board
Forty-ninth executive session
Geneva, 8-9 June 2010
Item 2(a) of the provisional agenda

Note by the UNCTAD secretariat

Executive summary

Until the recent global crises, LDCs as a group enjoyed a protracted period of improved performance in the areas of economic growth, macroeconomic stability, trade and investment, resource flow and balances. However, this robust performance was relatively skewed and fragile and as such could not catalyse a breakthrough for structural progress. Changes have been particularly lagging in the areas of investment in productive sectors, trade diversification, infrastructure development, science and innovation capacity-building. In order to accelerate a transition towards structural progress, there is a need to revisit the development approaches in LDCs and development partners, particularly in the light of their recent development experiences and the challenges brought about by the fuel, food and financial crises. A new vision of the development paths for LDCs needs to include a facilitating macroeconomic framework, innovative meso-level interventions and a new set of international support measures addressing the specific needs of an increasingly heterogeneous LDCs group.

1 ^{*}This document was submitted on the above-mentioned date because the provisional agenda was approved by the Trade and Development Board on 15 April 2010.

2 ^{**}This is an abridged version of the report of the UNCTAD Ad hoc Interdivisional Task Force on LDC-IV. It has been prepared for the executive session of the Trade and Development Board, Geneva, 8 June 2010.

I. Introduction

A. Background and objectives

1. Forty-nine LDCs currently host 12 per cent of the world's population, half of which live in extreme poverty, but account for less than 2 per cent of world's gross domestic product (GDP) and around 1 per cent and 0.5 per cent of world trade in goods and services, respectively. Their development prospects are constrained by several socio-economic and geophysical structural impediments, which have made them extremely vulnerable to external shocks as well as to the adverse consequences of environmental change. The recent devastating earthquake in Haiti and earlier the tsunami in Samoa have pointedly brought out the vulnerabilities of the LDCs. Indeed, since the creation of the LDC category in early 1970s only two countries have graduated, while the initial number (25 States) has doubled.

2. In order to articulate any future international development agenda in support of the LDCs, it becomes pertinent to discern the structural changes that have manifested in these countries since the adoption of the Brussels Programme of Action in 2001. The present exercise is essentially a strategic retrospect on the performance of the LDCs in the current decade. The findings are to contribute in evolving a collaborative development vision for an accelerated structural transformation of the LDCs.

B. Methodology and scope

3. The analytical approach of the present document is anchored in the concept of "structural progress". In this regard the terms "structural transformation" and "structural change" (in the positive sense) have been used interchangeably. The choice of this defining concept is informed by the fact that an LDC remains an LDC because of a varying set of structural handicaps or constraints. Structural progress constitutes irreversible advances of catalytic nature that help obliterating these handicaps or constraints in the LDCs.

4. Structural progress may be defined as an intertwined phenomenon that brings in new and complementary elements aiming at, inter alia, accelerating economic growth, augmenting capital formation, increasing skills for productivity growth, enhancing domestic resource inputs and improving the ability to deal with external shocks. These elements of structural progress seek to enhance productive capacity and quality of jobs, improve the composition of outputs and facilitate equitable poverty reduction. Structural change could also lead towards an export specialization that is more conducive to attaining the countries' development goals. From these perspectives, structural progress may be measured both as a process and as a set of outcomes.

5. Identifying structural progress may prove to be a challenging task given the existing large differences among and across the LDCs. Moreover, the paramount goal of structural progress goes beyond the Millennium Development Goals (MDGs), and beyond the objectives of progress toward graduation from LDC status.

6. The scope of the present report is circumscribed by the mandate of UNCTAD in the areas of trade and development and interrelated issues. In undertaking its analyses, the report has drawn on the accumulated wisdoms available in various UNCTAD flagship publications as well as other relevant literature. For consistency reasons, wherever possible, the analyses have been based on United Nations data sources.

7. Seven building blocks of the document attempt to highlight the role of structural progress in their respective areas.

II. Trends in selected macroeconomic indicators

A. Economic growth performance

8. The LDCs experienced their strongest growth performance ever in 2005 and 2006 and their growth rates surpassed the goal of 7 per cent mentioned in the Brussels Programme of Action. Due to their higher population growth, LDC performance in per capita terms has been more modest. However, LDCs' high growth performance during the past decade was not broad-based and large differences persist among the LDC groups (see table 2.1).

9. Oil-exporting LDCs grew at 9.1 per cent during 2001–2009, while

Table 2.1

Real GDP and real GDP per capita growth rates of LDCs

(Annual average growth rates)

	<i>Real GDP</i>					<i>Real GDP per capita</i>				
	<i>2001–2009</i>	<i>2001–2006</i>	<i>2007</i>	<i>2008</i>	<i>2009 (est.)</i>	<i>2001–2009</i>	<i>2001–2006</i>	<i>2007</i>	<i>2008</i>	<i>2009 (est.)</i>
LDC total	7.1	6.9	8.4	7.0	4.1	4.6	4.4	5.9	4.6	1.7
LDC Africa and Haiti	7.7	7.5	9.1	7.9	3.5	4.8	4.6	6.2	5.0	0.7
LDC Africa and Haiti less oil exporters	5.9	5.5	6.5	6.7	4.2	3.0	2.6	3.7	3.9	1.5
LDC Asia	6.0	5.7	7.0	5.2	5.5	4.2	3.9	5.2	3.5	3.7
LDC islands	6.2	7.5	6.4	4.4	0.0	3.8	5.2	3.8	2.0	-2.3
Other developing countries	6.3	6.4	7.6	5.4	1.5	4.9	5.0	6.3	4.1	0.3
LDCs according to export specialization										
Agri and food exporters	8.2	8.6	9.8	6.6	8.4	5.0	5.2	6.4	3.4	5.0
Fuel exporters	9.1	9.1	11.3	8.2	2.7	6.9	6.8	9.2	6.1	0.7
Manufacture exporters	5.7	5.5	6.3	5.8	4.3	3.8	3.5	4.4	4.0	2.6
Mineral exporters	5.4	5.5	5.0	5.6	3.1	2.6	2.6	2.3	2.8	0.4
Service exporters	6.6	5.8	7.9	7.8	5.1	3.8	3.1	5.1	4.9	2.2

Source: UNCTAD Globstat and IMF World Economic Outlook October 2009.

manufacture and mineral LDCs grew at 5.7 per cent and 5.4 per cent, respectively. Thanks to the oil exporters, the growth rates of African LDCs were above the group's average. The commodity boom of the recent past fuelled the growth performance of

non-manufacturing industries (extractive and construction activities). The modest performance of the fuel- and mineral-exporting LDCs in 2009 and the recent performance of the agriculture and food exporters is closely linked to the swings in the global demand and prices.

10. The export-led growth model that many LDCs have followed has had varied results, since as few as seven LDCs (Angola, Bangladesh, Cambodia, Chad, Equatorial Guinea, Sudan and Yemen) alone accounted for 74 per cent of total LDCs' exports in 2008, and oil-exporting LDCs alone accounted for 62 per cent of total LDC exports. The sustainability of the growth prospect of LDCs is endangered by the relatively high occurrence of conflicts, natural disasters and market volatility.

B. Changes in GDP composition

11. The GDP of LDCs remain dominated by services (43 per cent), followed by industrial activities (31 per cent), which are mostly linked to mining, and lastly by agriculture whose weight has been falling over time to reach 26 per cent of GDP in 2006-2008 (see table 2.2). These averages mask the large differences amongst the LDCs and the individual GDP components. The share of manufacturing in GDP

Table 2.2
GDP composition by sectors
 (Percentage of total value added)

	1990-1992	2000-2002	2006-2008
LDC			
Agriculture	36	30	26
Industry	21	25	31
of which Manufacturing	10	10	10
Services	43	44	43
African LDCs			
Agriculture	37	32	28
Industry	21	25	32
of which Manufacturing	9	8	8
Services	42	43	40
Asian LDCs			
Agriculture	33	27	23
Industry	21	26	29
of which Manufacturing	11	12	13
Services	44	45	47
Island LDCs			
Agriculture	28	21	22
Industry	14	14	14
of which Manufacturing	7	7	6
Services	58	64	64

Source: UNCTAD Globstat.

has been stagnant over the past 18 years. Marginal progress has only been recorded by Asian LDCs, driven by their specialization in low technology manufactures (primarily textiles). Compared to the previous decade, half of the LDCs have experienced a deindustrialization process, measured by the declining share of manufactures in total output, and for 18 LDCs the share of agriculture in GDP has increased.

12. This sectoral pattern of growth indicates the failure to develop productive capacities and to modernize the economy in a way that would have led to a structural transition towards more manufacture-based economies. Furthermore, the resulting sluggish structural change observed does not adequately respond to labour market demands.

C. Resource balances

1. Fiscal resources

13. Revenue from taxes has increased in the LDCs from 13 per cent of GDP in 2001 to 16.3 per cent of GDP in 2007, the latest available year. Available data reveal that LDCs are still relying more on taxes raised from international trade than on domestically-raised taxes. Taxes on international trade accounted for 5 per cent of GDP in 2007, up from 3.5 per cent in 2001.

(a) In spite of the large trade liberalization efforts undertaken by the LDCs during the late 1980s and 1990s, import-related income still accounted for 35 per cent of LDCs' tax revenue in 2007, while taxes on exports accounted for a mere 1.7 per cent;

(b) Taxes of income, profit and capital gains have remained stable after 2001, accounting for a quarter of the share of total taxes, and accounting for 15 per cent of government revenue in 2007;

(c) The share of taxes on goods and services — which includes taxes on general sale and turnover, valued added tax and taxes on services and extractive activities — in total tax revenue has only marginally increased over time: from 23 per cent in 2001 to 25.6 per cent in 2007.

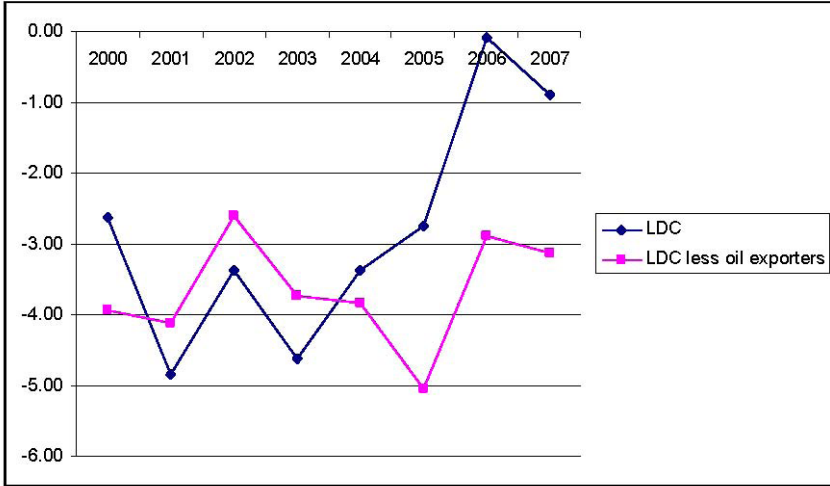
2. Current account and operating balances

14. LDCs have managed to improve their macroeconomic position from the 2000s onward due to a drastic rebalancing viewed as necessary under the conventional consensus. The commodity price-driven export boom and, in some cases, the buoyant remittance flow from expatriate workers, led to significant improvement in their current account balance from -4.8 per cent of GDP in 2001 to -0.9 per cent of GDP in 2007 (see figure 2.1). The exclusion of the oil exporters shows that the current account balance of the remaining LDCs did not improve much over time, although it has a positive upward sloping trend. While the Asian and island LDCs have experienced a current account surplus since the mid-2000s, their African counterparts are still faced with a current account deficit.

Figure 2.1

Current account balances for LDCs and non-oil exporting LDCs

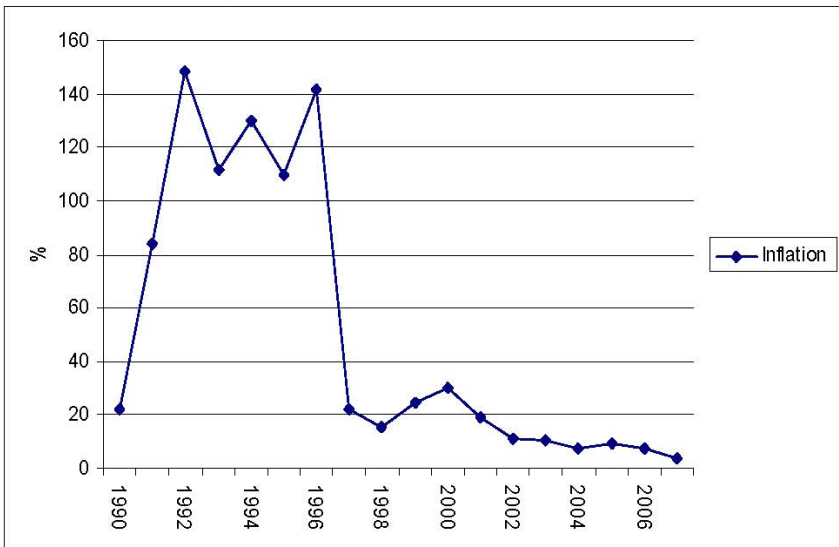
(Percentage of GDP)



Source: UNCTAD Globstat.

Figure 2.2

Inflation in the LDCs (1990-2007)



Source: World Bank, World Development Indicators.

15. The available scatter data on six LDCs³ indicate that their fiscal balance has improved during the past decade.

D. Inflation

16. The very high average inflation rates of the 1990s in LDCs dropped drastically by the beginning of 2000s. This contributed to a stabilization of domestic prices, attracted foreign investors and reduced the cost of borrowing, thus providing a climate more suitable for sustained economic growth and job creation.

E. Employment and poverty

17. During the past decade, available data indicate that the LDCs have not experienced the social improvements and employment advances that the rapid growth rates would have led to expect. Information on 13 LDCs suggests that agricultural employment still accounts for between one third and 80 per cent of total employment, depending on the country and its specialization. Industrial employment, on the other hand, does not seem to account for more than 10 per cent of total employment.

18. Estimates on the evolution of poverty rates during the past decade have given conflicting messages. One study found that poverty has been falling since 1995 much more and faster than was ever thought, introducing for the first time the possibility of seeing the LDCs meet the MDG on poverty.⁴ On the other hand, UNCTAD found that progress in reducing extreme poverty has been slow, much slower than that required to achieve the MDGs, and that there has been no acceleration in poverty reduction after 2000.⁵

19. While the group average of the “Gini” coefficient has remained stable around 0.4 throughout, many growth-virtuous countries experienced some deterioration of income distribution.

F. Crises and thereafter

20. Throughout the 2000s the LDCs have been exposed and hit by three different crises: the fuel, food and financial/economic crises. The financially poor LDCs have fended off the first two crises through temporary increases in government fiscal deficit and by cutting back on other expenses — mostly linked to social services — to pay their fuel and food bills. The six oil-exporting LDCs⁶ have been the only ones to benefit from the (temporary) increases in oil prices, while invariably all LDCs — even the food-exporting countries — have been hit at various degrees by the increases in the price of food and fuel. Rising food and fuel

3 Benin, Burkina Faso, Cambodia, Madagascar, Mali and Niger.

4 Pinkovskiy M and Sala-i-Martin X (2010). African poverty is falling ... much faster than you think! NBER Working Paper No. 15775.

5 UNCTAD (2008). *The Least Developed Countries Report 2008: Growth, Poverty and the Terms of Development Partnership*. United Nations Publication. Sales No. E.08.II.D.20. New York and Geneva.

6 Angola, Chad, Equatorial Guinea, Sudan, Timor-Leste and Yemen.

prices not only affected government finances, but also jeopardized incomes and savings of poor households.

21. As a result of the recent global financial/economic crisis, many of the poorest countries believed that they would be the hardest hit. A study concluded that due to this crisis the number of poor in LDCs was to rise by 6.1 million in Africa and by 1.2 million in Asia by 2010.⁷

22. The International Monetary Fund (IMF) reported that sub-Saharan Africa's real GDP growth was better than expected (at 1.6 per cent), and it forecast a strong recovery up to 4.3 per cent by 2010. Some argue that such a performance could be explained by their improved macroeconomic management, well-capitalized and less leveraged banks, diversification of export markets toward emerging economies, continued flow of remittance income, quick introduction of counter-cyclical policies and safety net programmes. However, this indication of improved resilience to shocks should not obfuscate the fundamental challenge of implementing structural progress in the LDCs.

23. Questions remain as to why the apparent improvement in the LDCs' macroeconomic situation and resilience to withstand possible external shocks have not led to an allocation of resources to more productive sectors and, thus, to structural progress.

III. Structural Progress in LDCs: Varying Experience

24. The growing heterogeneity among LDCs points to the need for a differentiated examination of the structural progress or lack thereof in the group. Few globally available indicators allow a meaningful measurement of improvements in LDCs' capabilities. Two of these indicators are the gross rate of secondary school enrolment and the rate of Internet penetration. Simultaneous examination of different indicators reveals that less than a third of all LDCs demonstrate meaningful improvements in capabilities.

25. In their quest for development, most LDCs aim to improve their export specialization, through increased competitiveness of existing activities, or diversification into new activities. Improved specialization often leads to socio-economic benefits, notably through a pattern of intersectoral linkages with poverty-reducing and welfare-enhancing effects. Natural endowments and cultural/educational assets are common determinants of economic and export specialization among LDCs. A detailed analysis of changes in the export specialization of LDCs during the past decade points to the following broad patterns, with varying manifestation across the countries:

(a) Seven countries have continued to specialize in agriculture or forestry (primarily for export) and have not experienced major structural changes: Burkina Faso, Burundi, Guinea-Bissau, Malawi, Solomon Islands, Somalia and Timor-Leste;

⁷ Karshenas M (2009). The impact of the global financial and economic crisis on LDC economies. UN-OHRLSS Technical Report. New York.

(b) Seven LDCs have maintained a combination of activities ranging from agriculture, fisheries or minerals to light manufacturing and/or services (Afghanistan, Benin, Ethiopia, Liberia, Mali, Mauritania and Uganda);

(c) Six countries continue to exploit their mineral endowment and have not recorded much change in their export specialization: Central African Republic, Democratic Republic of the Congo, Guinea, Niger, Sierra Leone and Zambia;

(d) Five LDCs are completely or in the process of being completely specialized in hydrocarbons (Angola, Chad, Equatorial Guinea, Sudan and Yemen). In none of these economies has the rapid specialization in oil exports brought widely shared benefits for the population;

(e) Four countries have soundly progressed toward specialization in textiles (clothing, garments and other textile products), a sector that often accounts for more than half of total exports of goods and services (Bangladesh, Cambodia, Lesotho and Nepal);

(f) Manufacturing and service activities dominate the economies of Bhutan, Mozambique and Togo;

(g) The export sector of nine countries is sizeably dominated by the tourism industry (Comoros, Gambia, Maldives, Rwanda, Samoa, Sao Tome and Principe, Senegal, the United Republic of Tanzania and Vanuatu);

(h) Djibouti and Eritrea have specialized in port and transport-related services;

(i) Four countries demonstrated, up to 2008 or 2009, a balanced mix of primary, manufacturing and service-related activities (Haiti, Lao People's Democratic Republic, Madagascar and Myanmar).

(j) Finally, two countries (Kiribati and Tuvalu) remain emblematic examples of economies dominated by "rental income", i.e. revenue arising from assets that were inherited from unique geographical or exotic features, as opposed to endogenous productive capacities.

26. Only 12 of the 49 LDCs stand out as having improved their specialization fairly rapidly, albeit with uneven consequences for the standards of living. These are the countries that have increased their export specialization in textile and tourism. By the end of the period considered, three sectors seem to be dominating the export revenue of 18 LDCs: hydrocarbons, textiles and tourism, with varying economic consequences. With hydrocarbons, countries have experienced rapid increases in per capita income levels, which were not underpinned by growth in domestic capabilities. In the case of low technology manufacture and textiles, some structural progress is observed as a result of expanded employment opportunities. Lastly, the effect of the dominance of tourism has shown that it could lead to spectacular income increases and social advances, but the overall improvements in living standard depend on the spillover effects on the remaining sectors of the economy.

A. Structural progress, graduation from LDC status and the MDGs

27. While genuine structural progress almost certainly implies progress toward thresholds of graduation from LDC status, the reverse is not true, because rapid advances in per capita income (a key graduation factor) may take place while the graduating country remains highly vulnerable economically. At the same time, structural progress will probably coincide with improvements in meeting the MDGs, while advances under the MDGs do not warrant structural progress. Only the latter stands out as a criterion of true significance for durable socio-economic betterment.

28. Only three countries are presently in the process of graduating from LDC status, while 10 others have demonstrated significant progress toward LDC graduation thresholds, and seven countries can be regarded as potential graduation cases in the long run (see table 3.1). To qualify for graduation, an LDC must have met the graduation thresholds under at least two of the three criteria (per capita income, the human assets index and the economic vulnerability index), through at least two consecutive triennial reviews of the list. The United Nations has stressed the importance of securing a smooth transition for countries that will be graduating from LDC status, during the three-year transition period that precedes the loss of LDC status.

Table 3.1
The graduation prospects of 20 LDCs

<i>Countries graduating From LDC status (graduation date)</i>	<i>Countries having already met one graduation threshold and pursuing progress under a second graduation threshold in the not-too-distant future</i>	<i>Countries showing signs of progress towards one or two graduation thresholds in the long run</i>
Equatorial Guinea (<i>to be determined</i>)	Angola	Cambodia
Maldives (<i>2011</i>)	Bangladesh	Comoros
Samoa (<i>to be determined</i>)	Bhutan	Lao People's Democratic Republic
	Kiribati	Mauritania
	Lesotho	Solomon Islands
	Myanmar	Timor-Leste
	Nepal	Yemen
	Sao Tome and Principe	
	Tuvalu	
	Vanuatu	

Source: UNCTAD, based on continuous monitoring of the evolution of the LDCs with respect to the inclusion criteria.

IV. Integrating in the Global Economy: Trade Performance of LDCs

A. Differential trade performance

1. The role of trade

29. During the current decade, LDCs' trade performance has boomed thanks to buoyant international prices and the increasing volumes of exported goods, which were driven by the expanding international demand. Their total trade increased from slightly more than half of their GDP (2000–2002) to about 70 per cent of GDP in 2006–2007 (see table 4.1), but it still accounts for less than 1 per cent of world trade. The decade has been marked by robust import and export growth rates, the latter growing faster (at 20 per cent per annum during the period considered) than the former. Thanks to the trade surplus of the oil exporters, the LDC group has experienced a shrinking trade deficit, which masks the deterioration of the trade balance of the remaining countries. Given the geographical features of the island LDCs, it is not surprising to find that their GDP is overly reliant on trade (in services).

Table 4.1

LDCs' trade in merchandise goods and services

(Percentage of GDP)

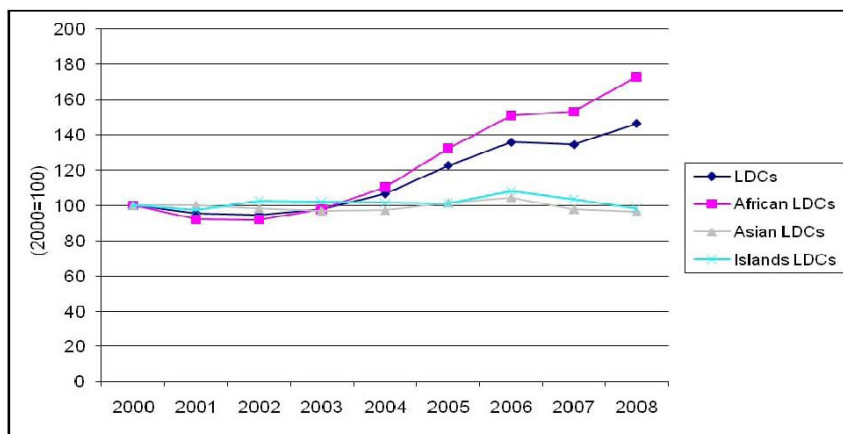
<i>Variables</i>	<i>Periods</i>	<i>LDC groups</i>				
		<i>LDCs</i>	<i>African LDCs</i>	<i>African LDC less oil exporters</i>	<i>Asian LDCs</i>	<i>Island LDCs</i>
Total trade	2000-2002	54.7	58.1	50.3	48.8	119.5
	2006-2007	70.1	76.7	61.9	57.6	112.5
Exports	2000-2002	23.8	25	19.4	21.8	47.4
	2006-2007	34.4	38.7	24	26.7	40.1
Imports	2000-2002	30.9	33.1	30.9	27	72
	2006-2007	35.7	38	37.9	30.8	72.4

Source: UNCTAD Globstat

2. Terms of trade

30. The net barter terms of trade for the LDCs as a group has shown a marked improvement from 2000 to 2008 (see figure 4.1). This positive result is driven by the performance of the African LDCs, whose terms of trade are closely related to the trend in commodity prices. The stagnation of the terms of trade for Asian and island LDCs during the 2000s, compared to the improved terms of trade for the LDC as a group, can be explained by changing nature of the LDCs' comparative advantage away from manufactures and services, towards commodities.

Figure 4.1
Terms of trade indices



Source: UNCTAD Globstat.

3. Product composition

31. LDCs' exports are heavily concentrated on a few products (see section V). Such an export concentration has always been an adverse structural feature of the LDCs. The recent trend in commodity prices has reinforced this trend by increasing the weight of those commodities and discouraging economic diversification. As shown in table 4.2, the LDCs have increased their export concentration in fuels, moving from some 40 per cent of total exports in 2000-2002 to 59.4 per cent in 2007-2008, while the export share of manufactures has decreased from 29 per cent in 2000-2002 to 19 per cent in 2007-2008. The above trend is due to the rapid increase in the price of commodities, which has boosted exports in fuels and minerals, and by the increased international competition in low technology, labour-intensive manufactures and the resulting fall in prices.

32. Compared to the increase of merchandise trade (25.2 per cent), LDCs' service exports increased at a more modest level (15.2 per cent): from \$7.6 billion in 2001 to \$18.5 billion in 2008. In 2008, service exports (mostly tourism) accounted for 3.6 per cent of LDCs' GDP. Some LDCs, mainly the small and insular ones, are more dependent on service receipts than others.

4. LDC trade and the financial crisis

33. The shrinking in global demand due to the global financial crisis paired with the drying up of trade finance caused a sharp contraction of international trade in goods and services, which did not spare the LDCs (see section II). According to one study, the export value from LDCs declined by over 43 per cent during the first two quarters of 2009, compared to the first half of 2008.⁸ Some products were

⁸ International Trade Centre (ITC) (2010). *ITC trade map factsheet: LDC trade recovery in 2009*. www.intracen.org

Table 4.2

Composition of LDCs' merchandise exports by main categories*(Percentage of total exports)*

<i>Variables</i>	<i>Periods</i>	<i>LDC groups</i>				
		<i>LDCs</i>	<i>African LDCs</i>	<i>African LDC less oil exporters</i>	<i>Asian LDCs</i>	<i>Island LDCs</i>
Primary commodities less fuels	2000-2002	30.2	40.4	72.9	14.2	62.6
	2007-2008	21.2	22.2	72.6	17.5	75.7
Fuels	2000-2002	39.5	48	5.3	27.2	0.1
	2007-2008	59.4	70.5	6	27.3	0.9
Manufactures	2000-2002	29.1	10.2	20.2	57.8	33.4
	2007-2008	18.6	6.3	20.2	54.7	21.4
of which textiles	2000-2002	24.5	7.7	14.4	50.2	15.7
	2007-2008	14.3	3.2	10.8	47.1	0.6

Source: UNCTAD Globstat.

more affected than others during the crisis, either due to a price downturn (for fuels and minerals) and/or to a reduction in the volume of demand. Excluding fuels and minerals, which are subject to price volatility, LDCs' exports declined by 13.5 per cent. The crisis and the related export decline seem to have bottomed out in the first quarter of 2009. The market for primary commodities was one of the first to rebound.

34. The trade impacts of the crisis on LDCs were exacerbated by their export concentration, stronger competition in market of labour-intensive, low value added manufactures, laying off of expatriate workers in the affected developed and developing countries, and lower flow of tourists. However, remittance flows from expatriate workers turned out to be more resilient than merchandise export receipts.

B. Changing market destination and the rising importance of the South

35. Total merchandise exports among developing countries between 2001 and 2007 have more than tripled, growing from US\$752 billion to US\$2.4 trillion. LDCs' exports to the South have expanded considerably in value terms and their marginal share in South-South trade has increased from 1.7 per cent in 2001 to 2.4 per cent in 2007. As highlighted in table 4.3, the markets of developing economies represent 50 per cent of LDCs' total exports (mostly fuel and minerals), up from less than 40 per cent in 1995-1996. Although the export share of LDCs to developed countries decreased from some 60 per cent in 1995-1996 to 47.8 per cent in 2007-2008, these more mature markets continue to absorb the vast majority of LDCs' manufactured goods, from 67 per cent in 1995-1996 to 75.8 per cent in

Table 4.3

Export destination of LDCs products by sector

<i>Variables</i>	<i>Developed countries</i>		<i>Developing countries</i>		<i>of which China</i>	
	<i>1995-1996</i>	<i>2007-2008</i>	<i>1995-1996</i>	<i>2007-2008</i>	<i>1995-1996</i>	<i>2007-2008</i>
All products	59.6	47.8	38.8	50.3	4.1	23
Primary commodities	56.5	41.3	38.8	56.9	5	28.1
Primary commodities less fuels	56.3	42	37.8	53.5	1.6	10
Manufactures	67	75.8	27.6	22.9	0.6	1.4

Source: UNCTAD Globstat.

2007-2008.

36. In 2008, China overtook the European Union (EU) as the main importer of LDC products, purchasing roughly 23 per cent (mainly fuels and minerals) of LDC exports against 21 per cent for the EU (mainly manufactures). Other developing economies such as India and Thailand currently play a greater weight in LDC exports than in the past.

37. Seventy-three per cent of the total value of LDC exports to developing countries was granted duty-free status, which resulted mostly from the favourable treatment of their exports of fuel and minerals. While the average tariff faced by LDCs in developing countries was 12 per cent in 2006, agricultural exports were subject to far higher rates than non-agricultural goods.⁹ These figures illustrate the wide dispersion of product treatment affecting South-South trade. This leaves much room for improving LDCs' market access in developing countries.

C. Participation in the international trading system

38. Market access conditions for LDCs have improved over the years through the provision of trade preferences by both developed and developing countries (particularly Brazil, China, India and the Russian Federation), although rounds of multilateral and regional agreements have led to preference erosion for LDCs. Benefits from the conclusion of the WTO Doha Round remain unresolved. The major outstanding issues include duty-free, quota-free access for all products from all LDCs, simplification of rules of origin, dealing with non-tariff measures and standards, waiver for granting preference in services and fast-tracking of the LDC accession process.

39. The number of South-South regional agreements has drastically increased in the last decade. Between 1990 and 2003, 70 new South-South trade agreements were signed, 30 of which were between neighboring African countries.¹⁰ While

9 WTO (2010). *Market access for products and services of export interest to LDCs*. WT/COMTD/LDC/46/Rev.1.

10 Yang Y and Gupta S (2005). *Regional trade arrangements in Africa: past performance and the way forward*. IMF Working Paper WP/05/36.

Asian regionalism has focused on trade facilitation, regional agreements within African LDCs have mostly lowered trade protection measures among members.¹¹ The Economic Partnership Agreements between five main African regional arrangements and the EU, if implemented, will further liberalize EU–African trade, but on a reciprocal basis.

40. Experience suggests that improved market access alone is not sufficient to stimulate domestic productive capacity in a way that could lead to structural change in the LDCs. Along with the rebalancing of the role of external and domestic demands, specific supply-side policies are needed to reduce domestic constraints and enhancing existing production possibilities.

V. The State of Commodity Dependence

A. Increased commodity dependence

41. The latest available data indicate that LDCs, as a group, became increasingly commodity dependent from 2000–2008, with primary commodities rising in relative importance over manufacture exports. This outcome was largely the result of the rise in primary commodity prices during this period and the increase in their export volumes due to international demand (see section IV).

42. The dependence on a few commodities (or even on a single commodity export) has traditionally been a prominent feature of LDCs' commodity export structure. Available evidence points toward a pattern of increased export concentration, with a few commodities accounting for the bulk of export earnings. The Herfindahl-Hirschmann concentration index suggests that trade concentration had increased from 0.33 in 2000 up to 0.54 in 2008. However, this aggregate picture masks significant variations among regions. The overall increase in the degree of export concentration was essentially due to the African LDCs, whose index rose by 0.73 in the period 2000–2008, while the Asian LDCs exhibited a pattern of decreasing export concentration.

43. Another measure of the level of trade concentration is given by the export share of only the largest export categories. Table 5.1 shows that 14 out of 23 countries increased their dependence on a single export commodity (as a share of total commodity exports) in the latter period. Although driven by price factors, this finding corroborates the view that LDCs as a group have become increasingly commodity dependent in terms of export earnings, which entails greater exposure to price volatility.

B. Internal and external constraints

44. At the domestic level, horizontal and vertical diversifications towards the production of higher value added products have been structurally impaired by a number of supply-side constraints. These included: deficiencies in infrastructure;

¹¹ Borgatti (forthcoming). Economic integration in sub-Saharan Africa. In: Jovanovic M, ed. *International Handbook of Economic Integration*. London, Edward Elgar.

the paucity of support services; rudimentary technology; lack of access to credit; and untapped economies of scale.

45. To tackle these supply-side issues, an integrated programme of supply-side responses must be composed of:

(a) Enhanced institutional capacities – in the light of structural problems and in the aftermath of the recent financial and economic crisis, there may be a pressing need for more direct forms of state intervention in economic management;

(b) The pooling and alignment of funding – the two key challenges that LDCs face include aligning aid flows to the priorities expressed in LDCs' national development strategies and strengthening domestic resource mobilization;

(c) Increased effectiveness in the regional economic integration processes, with the objective of overcoming the constraints of small domestic markets and exploiting untapped economies of scale, including in technological development.

46. Domestic policies geared to export diversification in the LDCs are unlikely to be effective without complementary action at the multilateral level aimed at tackling both sets of constraints. In this connection, it is somewhat expedient to distinguish between market access conditions (discussed in section IV) and actual market entry barriers stemming from the structural characteristics of supply chains and markets. The latter include important structural (sunk costs, economies of scale, etc.) and behavioural (e.g., abuse of market power by incumbent firms) barriers.

47. Moreover, private sector standards, in interplay with the ongoing process of corporate concentration in the commodity sector, are creating asymmetrical market power in several commodity chains. Particularly in the context of vertically coordinated demand-driven agrifood chains, private standards have become de facto mandatory requirements having exclusionary effects.

Table 5.1
Changes in dependence on a single commodity export between 2000-2002 and 2006-2008

Country	2006-2008			2000-2002			Increase in share in 2006-2008		
	Commodity	Total merchandise exports (1)	Total commodity exports (2)	Commodity	Total merchandise exports (3)	Total commodity exports (4)	Total merchandise export (1-3)	Total commodity export (2-4)	Total commodity export (2-4)
Angola	333 - Crude petroleum	95.57	96.39	333 - Crude petroleum	89.34	89.62	6.23	6.76	6.76
Benin	263 - Cotton	46.08	53.60	263 - Cotton	38.33	62.92	-12.45	-9.32	-9.32
Burkina Faso	263 - Cotton	31.62	57.92	263 - Cotton	59.59	72.49	-27.98	-14.58	-14.58
Burundi	971 - Gold, non-monetary	38.15	51.57	071 - Coffee and coffee substitutes	62.95	63.62	-24.80	-12.05	-12.05
Chad	333 - Crude petroleum	61.13	63.79	263 - Cotton	74.55	80.65	-13.41	-16.86	-16.86
Equatorial Guinea	333 - Crude petroleum	84.76	88.56	333 - Crude petroleum	86.17	89.17	-1.42	-0.61	-0.61
Guinea	285 - Aluminium ores	60.11	70.16	285 - Aluminium ores	51.51	66.29	8.61	3.87	3.87
Guinea-Bissau	037 - Fruits and nuts	98.43	98.90	333 - Crude petroleum	60.67	61.57	37.76	37.32	37.32
Liberia	231 - Natural rubber	21.01	55.48	247 - Wood in the rough or roughly squared	10.23	45.04	10.78	10.44	10.44
Malawi	121 - Tobacco, unmanufactured	59.07	66.81	121 - Tobacco, unmanufactured	59.67	67.12	-0.59	-0.31	-0.31
Mali	971 - Gold, non-monetary	74.74	77.81	971 - Gold, non-monetary	65.52	69.32	9.22	8.48	8.48
Mauritania	281 - Iron ore	52.14	53.86	281 - Iron ore	55.53	70.91	-3.38	-17.05	-17.05
Mozambique	684 - Aluminium, refined	58.81	64.51	684 - Aluminium, refined	38.33	42.78	20.28	21.73	21.73
Niger	286 - Uranium or thorium ores	50.15	57.44	286 - Uranium or thorium ores	33.27	40.33	14.88	16.91	16.91
Niger	334 - Petroleum oils	88.92	90.32	334 - Petroleum oils	63.75	70.36	25.17	19.96	19.96
Sierra Leone	682 - Copper, refined	68.14	76.76	682 - Copper, refined	51.75	61.05	16.40	15.71	15.71
Laos	682 - Copper, refined	38.16	50.78	248 - Wood simply worked	21.34	45.92	16.82	4.87	4.87
Myanmar	343 - Crude natural gas	45.37	81.13	343 - Natural gas	17.95	27.31	27.43	23.82	23.82
Yemen	333 - Crude petroleum	80.40	83.91	333 - Crude petroleum	92.15	92.86	-11.75	-8.94	-8.94
Comoros	075 - Spices	63.95	99.97	075 - Spices	93.73	99.84	-29.78	0.14	0.14
Maldives	034 - Fish, fresh, chilled or frozen	78.42	78.55	034 - Fish, fresh, chilled or frozen	24.99	42.76	53.42	35.80	35.80
Sao Tome and Principe	072 - Cocoa	62.40	66.65	072 - Cocoa	88.75	91.28	-26.35	-24.63	-24.63
Solomon Islands	247 - Wood in the rough or roughly squared	66.73	70.06	247 - Wood in the rough or roughly squared	52.88	65.81	13.85	4.25	4.25

* in 2000, 2002 and 2008; Petroleum oils or bituminous minerals > 70% oil + Petroleum oils, oils from bituminous materials, crude

Source: UNCTAD Globstat. Data based on 3-digit SITC, rev. 3.

VI. Investment Promotion and Foreign Direct Investment (FDI) Flow

A. Aggregate investment trend

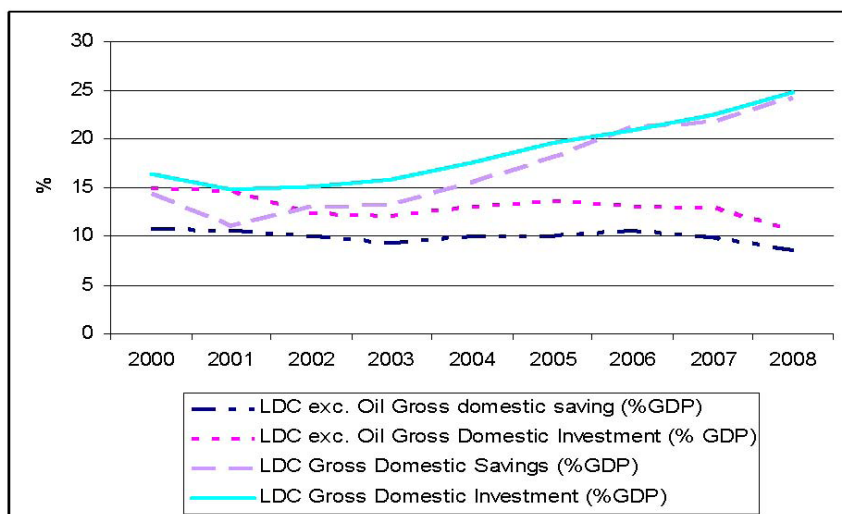
48. Although between 2000 and 2008, the LDCs as a group experienced a substantial increase in their gross domestic investment (from 16.4 per cent to 24.8 per cent of GDP) along with improved gross domestic savings (from 14.3 per cent to 24.2 per cent of GDP), their gross fixed capital formation as share of GDP increased by 4 percentage points, equivalent to half the increase in gross domestic investment. Whenever the export–investment nexus worked, domestic investment rose. It seems that such a nexus only worked for oil-exporting LDCs (see figure 6.1).

49. During the 2000s, LDCs as a group drastically reduced their resource gap – which measures their dependence on foreign savings – from 7 per cent of GDP in 2000–2002 to 1.6 per cent in 2006. At the same time, however, some of the most vulnerable LDCs increased their reliance on foreign savings to finance domestic investment and domestic consumption, highlighted by an increase in their resource gap. This raises questions on the future sustainability of the non-oil and mineral-exporting LDCs' growth performance as well as on the effective impact on domestic investment and savings for the natural resource-dependent LDCs.

Figure 6.1

Domestic investment and savings in LDCs and non-oil exporting LDCs

(Percentage of GDP)



Source: World Bank, World Development Indicators, 2010, online.

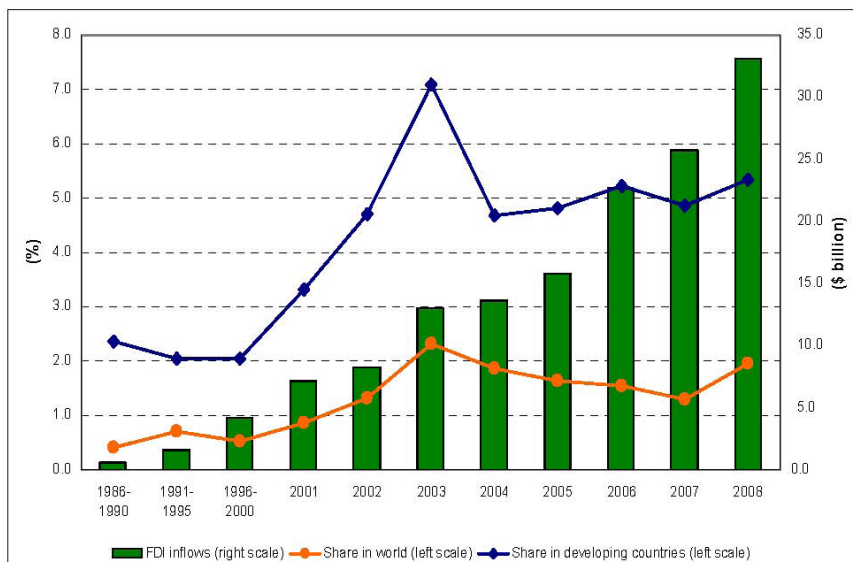
B. The FDI inflows

50. Since the 1980s, LDC governments have pursued proactive foreign investment promotion policies, which have led to an increase in FDI flows to LDCs. These grew at an annual rate of 25 per cent to reach \$33 billion by 2008, compared to \$7.1 billion in 2001. However, the FDI flows to LDCs accounted for a meagre 2 per cent of the world total in 2008 (see figure 6.2).

Figure 6.2

FDI inflows into the LDCs and their share in world inflows and developing country-inflows, 1986–2008

(Billions of dollars and percentage)



Source: UNCTAD, FDI/Transnational Corporation (TNC) database.

51. The particular combination of geographical, historical and structural forces in LDCs, and African LDCs in particular, has traditionally attracted FDIs into enclaves of export-oriented primary production. Such FDIs tend to be more volatile than those to the manufacturing sector. Moreover, FDI in the LDCs continued to remain concentrated in a handful of countries (seven LDCs accounted for more than half of total FDI inflows to LDCs in 2008).

52. Concurrently, FDI mainly targeted extraction industries and investment in oil-exporting countries in Africa during the 2000s, accounting for more than 60 per cent of total inflow. However, some of the sectors such as food, beverages and tobacco have been targeted as important sectors by foreign investors during the 2000s. High investment was observed in some labour-intensive service sectors (transport, storage, communications, and hotels and restaurants).

53. In 2008, the bulk of FDI was in the form of greenfield and expansion projects prospecting for reserves of base metals and oil, in addition to some investments in infrastructure. Large services FDI projects were mainly through mergers and acquisitions. Among the components of investment, reinvested earnings comprise a major share of FDI inflows in the case of natural resource-exporting countries, because of long-term commitments and relatively large profits in mining and extraction.

54. Although developed countries were the main source of FDI for LDCs during the 2000s, LDCs also increasingly attracted FDI from developing countries such as China, India, Malaysia and South Africa, as well as from the Russian Federation. While the biggest Chinese investors are state-owned enterprises, Chinese private investors also became increasingly active players in Africa. In addition, regional investments within Africa have also recently been on the rise.

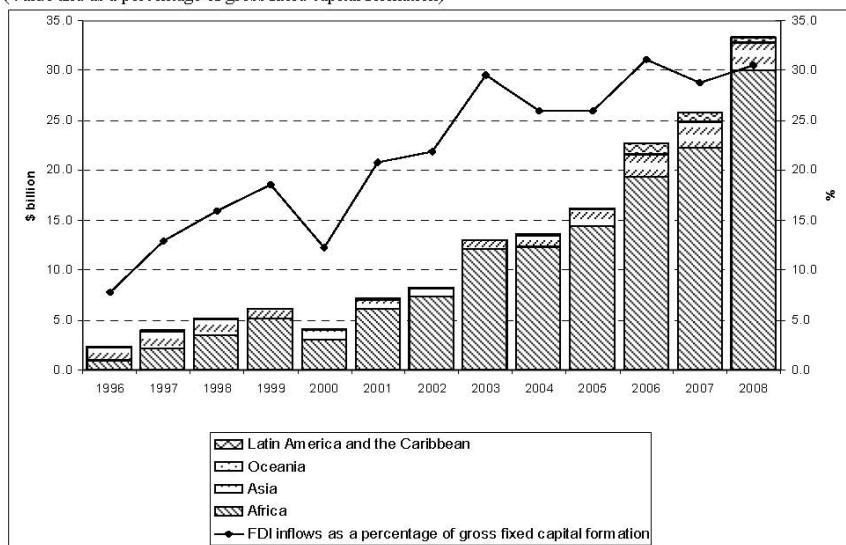
C. FDI and domestic investment

55. Although the share of FDI flows in gross fixed capital formation increased in the last 15 years to reach some 30 per cent, up from some 12 per cent in 2000 (figure 6.3), profit remittances on FDI have soared, reaching a capital outflow of US\$12.2 billion by 2006. The overall net effect on the domestic economy is thus unpredictable and likely to be country-based.

Figure 6.3

FDI inflows to LDCs, 1996-2008

(Value and as a percentage of gross fixed capital formation)



Source: UNCTAD, FDI/TNC database.

56. It is conventionally assumed that foreign affiliates can contribute to the growth of domestic firms and investment (“crowding in”) through vertical inter-firm linkages with such firms, or through the creation of subnational or subregional clusters of interrelated activities. But existing evidence¹² on crowding in is not conclusive, and generally for it to occur, a high share of domestic capital formation is needed to offset possible “crowding out” effects. UNCTAD research finds that FDI is crowding in domestic investment, i.e. a dollar of FDI leads to an increase of investment by more than one dollar in the most of LDCs countries. However there are differences in terms of the impact in LDCs in Africa and Asia. While neutral effects seem to prevail in Africa, the crowding in effect dominates in manufacture-exporting Asian LDCs.

57. Differences in the effects of FDI on domestic investment between those two groups of economies imply that national development strategies and investment policies such as policies strengthening linkages between foreign affiliates and domestic firms should be coordinated to ensure maximized synergies between FDI and domestic investment.

D. Future outlook

58. FDI flows to LDCs are likely to decline in the future because of the lower expectation of profitability by TNCs during the recovery from the global financial crisis and continued volatility in the global demand for and prices of oil and minerals. In this context, the decline in FDI inflows to LDCs in 2009 is a matter of grave concern.

59. Although most LDCs have been making efforts to improve the investment environment over the years, they do not seem to have managed to attract FDI in productive sectors. Some oil-producing countries in Africa are seeking to ameliorate their policies to increase linkages with the domestic economy and therefore better benefit from FDI in the oil industry. Even though many LDCs have paid increased attention to policy initiatives at the bilateral, regional and multilateral levels in order to enhance their investment absorption through their international integration measures, there is a clear need to revisit the role of domestic investment.

VII. Building Capacities for Structural Progress: Transport Infrastructure; Science, Technology and Innovation (STI); and Information and Communication Technology (ICT)

A. Investment in transport infrastructure, connectivity and electricity

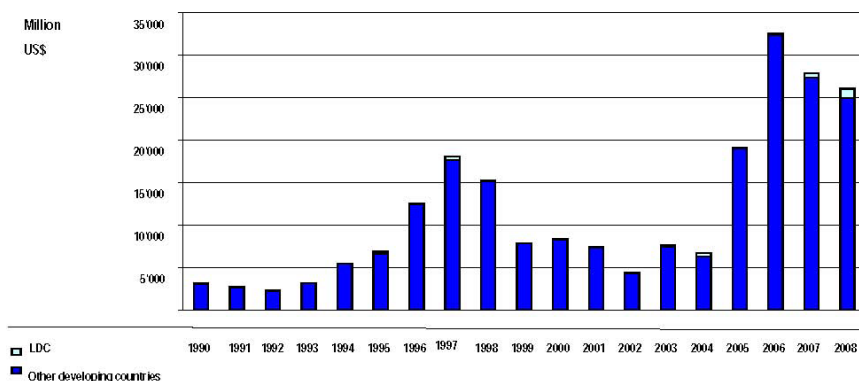
60. Weak infrastructural provisions, particularly trade-related ones, have been considered to be one of the main obstacles towards structural progress in LDCs, particularly in landlocked LDCs. The reduced share of LDCs in global private sector investment in transport infrastructure between the 1990s and the 2000s grew

¹² Udomkerdmongkol M and Morrissey O (2008). *Political regime, private investment and foreign direct investment in developing countries*. UNU WIDER Paper No. 2008/109.

from US\$0.7 billion (0.9 per cent) to US\$2.7 billion (1.9 per cent) (see figure 7.1). The number of projects in the LDCs also increased from 12 out of 337 (1990s) to 31 out of 441 (2000s). During the 2000s, investments in seaports in LDCs grew by more than 27 times to reach US\$1.8 billion (5.4 per cent).

Figure 7.1

Project investment in transport infrastructure, 1990-2008



Source: UNCTAD secretariat, based on data from World Bank and PPIAF, PPI Project Database, <http://ppi.worldbank.org>.

61. Table 7.1 reveals that, according to UNCTAD’s Liner Shipping Connectivity Index (LSCI), LDCs are among the least connected countries, because national trade volumes tend to be lower and lower levels of development make ports less attractive for transshipment and transit cargo. However, investment in port infrastructure and the introduction of private sector operations made several LDC seaports more attractive as ports of call for international liner shipping companies.

Table 7.1

Average LSCI rankings of country groups, 2009

	<i>Developed countries</i>	<i>Economies in transition</i>	<i>Developing countries</i>	<i>LDCs</i>	<i>Grand total</i>
Africa			70	104	89
Asia	70	136	60	108	69
Europe	63	100			68
Latin America and the Caribbean	83		92	124	92
North America	86				86
Pacific	79		92	132	103
Grand Total	68	106	76	109	81.5

Source: UNCTAD calculations, based on data provided by Containerization International Online.

62. The average number of container shipping companies providing services to and from LDCs is one third of the global average, meaning that importers and exporters from LDCs have fewer choices when contracting containerized maritime transport. Empirically, the lower level of competition is closely correlated with higher freight rates and higher transaction costs for foreign trade. The global average per country of direct liner shipping service connections remained stable between 2006 and 2009, while it declined by 20 per cent in LDCs.

63. Power availability is an important precondition for development. UNCTAD analysis shows that an increase in electricity production is closely correlated with an increase in the manufactures share of merchandise exports. This finding implies that energy infrastructure is as important as transport infrastructure for trade development, employment generation and economic growth.¹³

B. STI

64. The building of a sound STI capacity in the LDCs is a prerequisite for long-term economic growth and poverty reduction. Policymakers in the LDCs have been increasingly implementing policies and strategies during the 2000s to build STI capacity, based on the conventionally understood technological transfers, with limited results. UNCTAD argues that to reverse this trend, the focus of those policies should be on proactive technological learning by domestic enterprises and on commercial innovation. This calls for the adoption and adaptation of existing technology to the local characteristics.

65. Analyses based on six selected LDCs show no distinguishable improvement in STI capacity over the last decade in these countries. For example, according to UNESCO data, expenditure on research and development (R&D) as a share of GDP has either decreased or slightly increased from a low base, accounting for less than 0.5 per cent of these countries' respective GDP. There are no clearly distinguishable trends, other than that R&D expenditures have been at insufficient levels. Furthermore, there has been no improvement during 1996–2006 in LDCs in terms of the supply of scientific professionals, while there is some stability in the numbers.

66. Between 2007 and 2009 UNCTAD conducted Science, Technology and Policy Reviews (STIP) Reviews in order to assess ground-level developments in three LDCs: Angola, Lesotho and Mauritania. These reviews reaffirmed the need for policy to be integrated and tailored to national development strategies. The key challenges for improving technology absorption are: lack of resources, limited technology flow in public–private partnerships, inadequate ICT and staffing in key institutions, lack of technical training facilities and brain drain.

67. Patents represent improved scientific and innovation capacities of a country. However, according to United States Patent and Trademark Office data, during 1989–2008 only 32 out of 3 million patents originated in the LDCs and, during the last five years, no more than 9 out of 1 million.

¹³ UNCTAD (2006). *The Least Developed Countries Report: Developing Productive Capacities*. United Nations publication. Sales No. E.06.II.D.9. New York and Geneva.

C. ICTs

68. Improved access to ICTs represents one of the most positive developments in the LDCs in the past decade. Improvements have been particularly significant in the case of mobile telephony (see table 7.2). Further exploitation of mobile telephony and of other ICT-type of improvements would be beneficial to the domestic structural transformation.

Table 7.2

Mobile telephone subscriptions per 100 inhabitants in LDCs, 2000 and 2007

(Number of LDCs with a certain penetration level)

<i>Number of subscriptions per 100 inhabitants</i>	<i>2000</i>	<i>2007</i>
Less than 1	41	2
1-10	7	14
10-30		28
More than 30		5
Data not available	1	
Total	49	49

Source: UNCTAD analysis of data from the International Telecommunication Union's World Telecommunication/ICT Indicators database.

69. Microenterprises in the agriculture and fisheries sectors in Africa and Asia now use mobile phones to obtain weather information and market prices, and to sell and purchase inputs as well as to negotiate prices. Most recently, mobile phones have become a tool for making financial transactions and providing insurance, and they represent a source of income for small vendors in developing countries.

70. However, the rural/urban divide in ICT access persists; less than one per cent of rural households in some LDCs has access to such ICTs. Even when ICT infrastructure is available, its use is often constrained due to inadequate supportive infrastructure (electricity).

71. According to the International Telecommunication Union, in 2009, the average price of a mobile cellular monthly price basket amounted to 5.7 per cent of per capita income. In developed economies the ratio was 1.2 per cent and in developing countries, 7.5 per cent.

72. In other areas, such as fixed telephony, Internet access and broadband connectivity, LDCs still remained very far behind other countries in 2008. In fixed telephony, there was less than one fixed line per 100 inhabitants, 24 Internet users per 1,000 LDC inhabitants, and in broadband connectivity, the world average penetration level was some 200 times higher than in the LDCs.¹⁴

14 UNCTAD (2009). *Information Economy Report 2009: Trends and Outlook in Turbulent Times*. United Nations Publication. Sales No. E.09.II.D.18. New York and Geneva.

VIII. Foreign Aid Inflow and Debt Scenario

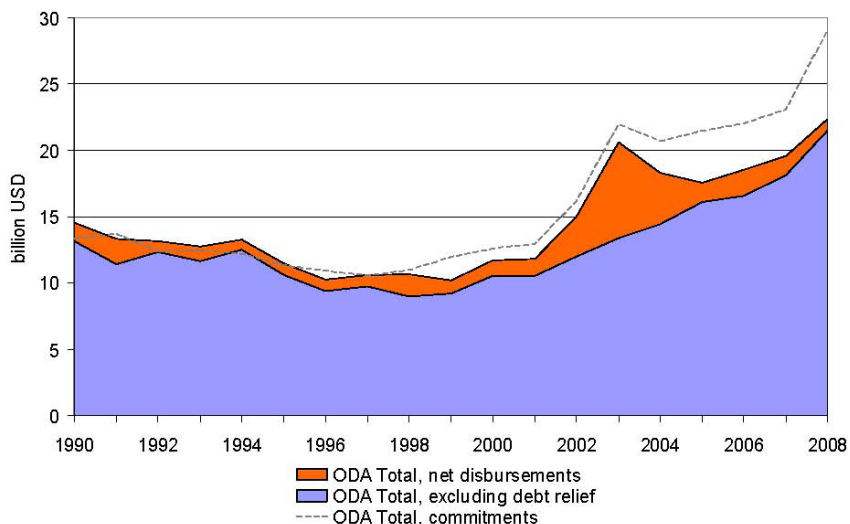
A. Trends in aid flows

73. One important aspect of investment financing in support of diversification and structural change in LDCs is their foreign exchange requirement for imports of capital goods (as well as other forms of development financing). Chart 8.1 shows that in spite of a steady increase in official development assistance (ODA) flows since 1998, both including and excluding debt relief, total net disbursed ODA flows to LDCs have remained well below the committed levels during the course of the last 10 years. In 2008, the real net official disbursements to LDCs excluding debt relief amounted to some US\$21.5 billion, against some US\$10.5 billion in 2000–2001. The record gap between real committed and effectively disbursed ODA (US\$6.7 billion) for 2008 reflects the impact of the financial crisis on the donors' financial accounts. Such a gap, which is likely to be reproduced again in 2009, is also likely to negatively affect the budget balance of the aid-dependent, agricultural-exporting LDCs, for which real net ODA disbursements accounted for one fifth of GDP in 2006–2008.

Chart 8.1

ODA and debt relief to LDCs

(Disbursements, in constant 2007 USD)



Source: OECD.

74. The increase in ODA inflows to LDCs needs to be assessed against the rapid building up process of international reserves¹⁵ (from US\$15 billion in 2000

¹⁵ UNCTAD (2008). *The Least Developed Countries Report 2008: Growth, Poverty and the Terms of Development Partnership*. United Nations Publication. Sales No. E.08.II.D.20. New York and Geneva.

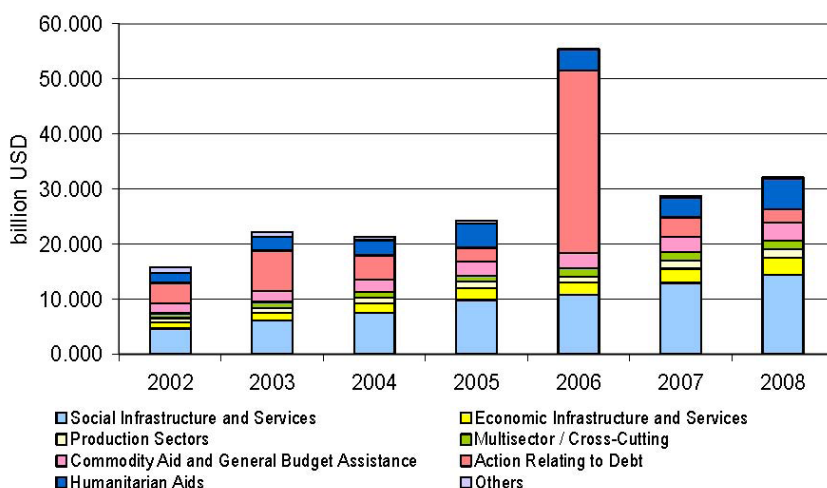
to US\$43 billion in 2006), which has reduced the availability of external resources for productive capacity and structural changes.

75. The developmental role of aid, in the form of enhancing productive capacity, creating employment, increasing domestic value added and contributing to structural change, seems to have been neglected in favour of overemphasizing social expenditures in the LDCs (see chart 8.2). In 2008, the share of disbursements going to economic infrastructure and production sectors amounted to 19 per cent, against some 43 per cent going to social infrastructure and services. However, in order to achieve structural change, increases in ODA for social infrastructure and services must be accompanied by increases in ODA for economic infrastructure and productive sectors.

Chart 8.2

Composition of ODA to LDCs

(Net disbursements, in constant 2007 USD)



Source: OECD.

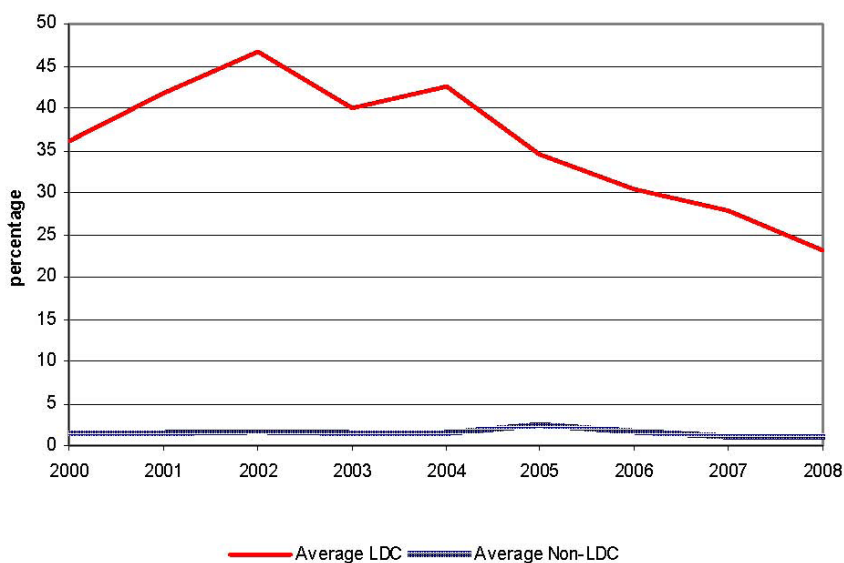
76. Although aid dependency is still high in LDCs compared to non-LDCs (chart 8.3), the overall trend for LDCs in the recent past has been encouraging (table 8.1). Aggregate figures masks the large differences that exist within the group: those economies that moved into manufacturing have decreased their aid dependence, which only accounts for some 3 per cent of their GDP. On the other hand, the agricultural- and mineral-exporting LDCs have experienced an increase in their dependency during the past decade, relying on ODA for some 20 per cent of their GDP. The net ODA/GNI (gross national income) ratio for the group in 2008 is projected to decline from 10.5 per cent (1990–1999) to about 7.9 per cent. This decreasing trend remains most perceptible for the African LDCs.

Table 8.1
Net ODA as per cent of GNI

	<i>Time periods</i>			
	<i>1990-1999</i>	<i>2000-2005</i>	<i>2007</i>	<i>2008 (projected)</i>
LDC	10.5	9.7	8.3	7.9
African LDCs	13.3	12.8	9.4	8.5
Asian LDCs	6.0	5.2	5.9	6.5
Island LDCs	15.2	17.9	14.8	12.7

Source: World Bank, World Development Indicators, online.

Chart 8.3
LDCs and non-LDCs: share of aid to government expenditure

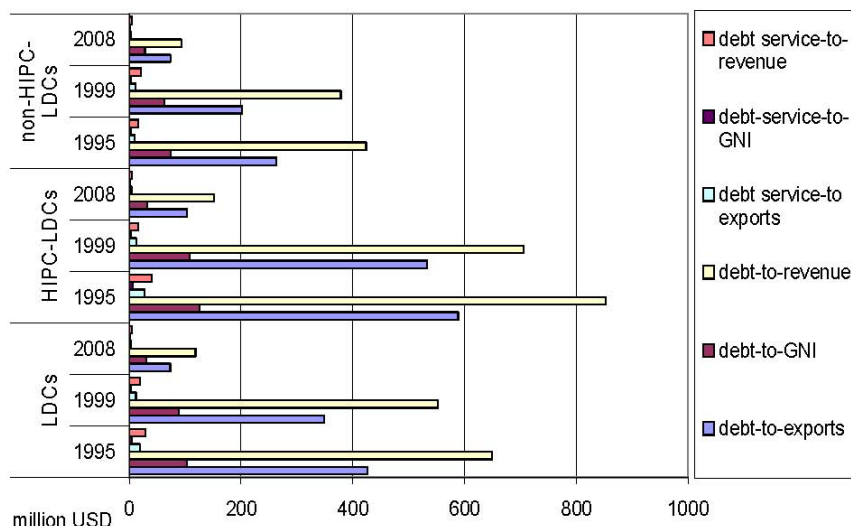


B. Debt scenario

77. Thirty-one LDCs are highly indebted poor countries (HIPC). Debt stock reductions associated with the HIPC and multilateral debt reduction initiatives coupled with robust international growth of the previous years led to an impressive improvement in debt indicators between 2003 and 2007 for developing countries in general and LDCs in particular. Chart 8.4 shows that all debt-related indicators of LDCs as a group and HIPC-LDCs in particular have improved: debt service-to-revenue, debt service-to-GNI, debt services-to-exports, debt-to-revenue, debt-to-GNI and debt-to-exports.

Chart 8.4

Debt indicators for LDCs, HIPC-LDCs, non-HIPC-LDCs



Source: World Bank Development Indicators.

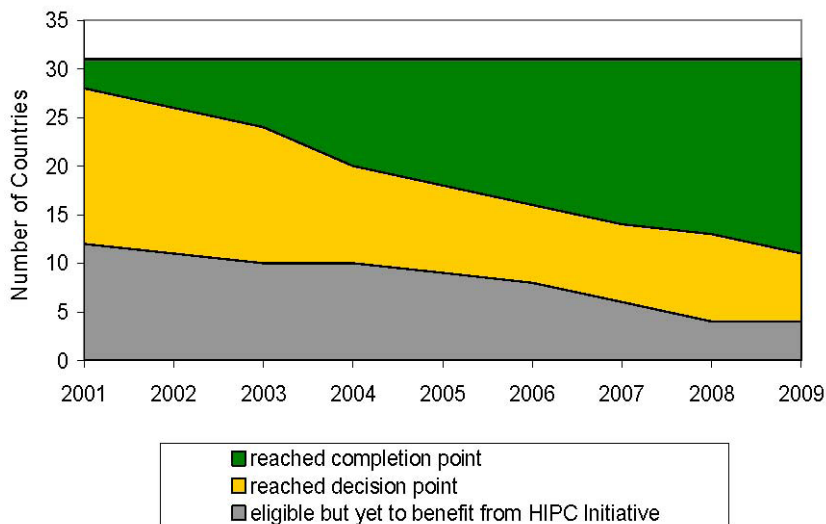
78. Furthermore, the number of LDCs reaching the completion point and benefiting from debt write-offs rose consistently during the current decade (see chart 8.5), contributing to the improvement of their debt indicators. Some LDCs have experienced dramatic improvements in their debt indicators in the 2000s. For example, Mozambique, Sierra Leone and Zambia managed to decrease their external debt stock as a percentage of their GNI from more than 180 per cent in 2000 to less than 45 per cent in 2007.

C. Crisis: aid flow and debt

79. HIPCs are affected by the global economic and financial crisis through a number of channels. Completion point countries are facing an average current account deficit of 8 per cent of GNI and the average current account deficit of decision point and pre-decision point countries exceeds 10 per cent of GNI. According to the IMF, the number of low-income countries, mostly LDCs, facing higher debt vulnerabilities remains significant. The relatively stable debt outlook for low-income countries hinges on the critical assumption that the crisis has no adverse long-term effect on economic growth. Continued and increased access to highly concessional finance is therefore needed to maintain debt sustainability beyond the completion point.

Chart 8.5

HIPC-LDCs: status over time



IX. Concluding Remarks

80. The global economic growth of the 2001–2008 period buoyed up many developing countries, particularly among the LDCs. Many of them experienced robust economic growth in a context of relative macroeconomic stability, with low inflation and improved resource balances, including sustained FDI and ODA inflows. However, it is doubtful whether this performance was the reflection of structural (catalytic, irreversible) progress in most LDCs. The group, during this period, was severely struck by the fuel and food crises, which affected their trade balance, but they demonstrated better resilience to the financial crisis than other developing countries. Overall, the opportunities and risks emanating from globalization forces entailed a greater international exposure of the LDCs, without convergence with more advanced economies for a large majority of them.

81. The marginal position of LDCs in world investment, trade and income remained more or less unchanged. Pockets of improvement cannot hide the structural weaknesses of these countries, the majority of which remain far away from LDC graduation thresholds and from meeting MDG targets. In most LDCs, structural progress failed to take place because opportunities to enhance capabilities and improve economic specialization were missed, while, inter alia, infrastructural development and science and technological capacities were insufficient to allow the economies to rise in relevant international value chains.

82. In order to accelerate structural progress, and in some cases reverse the deindustrialization process, there is a need to revisit the development approaches

pursued by the LDCs and their development partners, particularly in light of the lessons from recent global crises. The LDCs should undertake a prudent and strategic mix of macroeconomic, trade and investment measures, and achieve a balance between market reforms and policy interventions. Specifically, this will entail creating an enabling macroeconomic framework to facilitate structural progress, with active use of public expenditure, monetary policy and exchange rate management. Strategic interventions through trade and investment policies will be necessary to guide FDI and other external resources to productive capacity-building with employment linkages. A new generation of international support measures is desirable given the growing diversity of needs among LDCs, notably in areas such as infrastructure development and technological capacities. This implies the creation of sector-specific investment funds as well as special adaptation measures such as debt moratoria.

SG'S AD HOC EXPERT GROUP MEETING
UNLDC IV: KEY DEVELOPMENT CHALLENGES FACING THE LDCS
18-19 February 2010

(TD/B/EX(49)/CRP.1, 3 June 2010)

TRADE AND DEVELOPMENT BOARD
Forty-ninth executive session
Geneva, 8–9 June 2010
Item 2 (a) of the provisional agenda

Concluding Summary
by Chair, UNCTAD Inter-Divisional Task Force on UN LDC-IV*

UNCTAD has been mandated both by the Accra Accord and General Assembly resolutions to actively contribute to the preparations for the Fourth United Nations Conference on the Least Developed Countries (LDC-IV) under the lead role of the United Nations Office of the High Representative for the Least Developed Countries, Landlocked Developing Countries and the Small Island Developing States (UN-OHRLLS). The conference is scheduled to take place during the first half of 2011.

Last fall, an Ad-hoc Interdivisional Task Force has been set up by UNCTAD's Secretary-General with the chairmanship of his Special Adviser on LDCs, to coordinate in close collaboration with the Division of Africa and Least Developed Countries and Special Programmes UNCTAD's substantive inputs for the preparatory process of LDC-IV.

In this context, a one-and-a-half day Ad Hoc Expert Group meeting (EGM) was convened by the Secretary-General on 18-19 February 2010 in Geneva addressing key development challenges facing the LDCs. The EGM's discussions will feed into a document UNCTAD is preparing in the run-up to LDC-IV.

Presentations of invited panelists and UNCTAD's experts are available on UNCTAD's website at <http://www.unctad.org/Templates/Meeting.asp?intItemID=2068&lang=1&m=18891&year=2010&month=2>

Objectives

The first objective of this expert group meeting has been to improve our understanding of the dynamics which unfolded in the LDCs in the course of the last decade or more. From this point of view, the discussions of the past two days have led to significant improvements in our knowledge about the changes (or lack of them) happening in the LDC economies in the recent past.

* This conference room paper has not been edited.

The second objective has been to draw some critical lessons and major insights which have come out of the thought-provoking presentations, panel discussions and comments from the floor. We do now have a better appreciation of the key challenges faced by the LDCs, particularly in the post-crisis situation

Rather than doing an exhaustive review of the Brussels' Programme of Action, which had never been one of our goals, we have taken a much more strategic and, possibly, a smarter look at the dynamics of the LDCs' performance during the last decade or so. This meeting was not necessarily about getting recommendations on what LDCs need to do in the future; the explicit purpose was to strengthen our understanding of the past development patterns of the LDCs.

One major consensus resulting from the meeting is that nobody is enthusiastic about repeat of big decadal conferences that would produce non-prioritised long wish list of recommendations. Thus, the solutions to key development challenges facing the LDCs should be looked at in a different way - in terms of design and content as well as in their operational modalities. Having achieved this consensus is, in itself, one step forward as it constitutes the beginning of a new approach on how to deal with the problematique. As we move towards the preparation of LDC-IV, this message has to become stronger and more precise and should get more intellectual momentum.

LDCs and Structural Change

Regarding the performance of the LDCs the main points that were raised during the discussion were the following: LDCs' performance has improved during the past decade, but it remains marginal, narrowly-based, fragile and much differentiated. Such an improvement is still very far from what is required in order to catalyze the dynamism experienced by other developing countries that LDCs are aspiring for.

The meeting took note of the situation of LDCs with regard to the legitimate goal of progressing toward graduation from LDC status, in relation to the paramount objective of "structural change". Anchoring the performance assessment on the concept of structural change generated some debates including on appropriateness of similar concepts, e.g. "structural progress" and "structural transformation" were also considered.

It was noted that 10 of the 49 LDCs have been demonstrating significant progress toward graduation thresholds, and that there are 7 more potential graduation cases in the long run. These add to the current three graduation cases (Equatorial Guinea, Maldives, Samoa), while nearly 60 per cent of all LDCs (29 out of 49) do not foresee graduation in any near future. The experts noted that while genuine structural progress is likely to induce progress toward graduation thresholds sooner or later, the reverse is not necessarily true (indeed often debatable) as can be seen with the highly vulnerable countries that are or have been in the process of losing LDC status. Structural progress, a dynamic notion in essence, is relevant and important to all LDCs irrespective of their performance under graduation borders.

The need for better understanding of the interrelationship between the LDCs' graduation criteria, the MDGs and structural change was also emphasized. It was

recognized that the three move in the same direction. The question is whether they all move in tandem or there is a sequence whereby one follows the other. Notwithstanding the large improvements in meeting the MDGs and in implementing structural change, the issue of graduation, and related criteria, deserves further attention.

Another lesson that has come out clearly from the meeting is the issue of differentiated growth. The existing heterogeneity in the LDC group is expressed in the different endowments that countries have (initial conditions) and also in the performance and in the mix of policies adopted. Undoubtedly, the initial conditions determine a part of the overall performance, while the remaining part is explained by the dynamics and the implementations of the policies adopted. This issue of heterogeneity has come up mostly in relation to the different performance experienced by Asia and Africa and by oil exporters/manufacturing exporters vs. agricultural exporters. At the same time, however, this broad dichotomy between Asia and Africa may not hold; in the case of Lesotho, for example, a small country was able to undertake a large structural transformation from an initial agro-pastoral specialization into becoming a manufacture exporter.

When dealing with the common structural handicaps facing the LDCs, it was pointedly argued that we have to be sensitive to the individual needs of these countries.

Trade Performance

LDCs' continue to remain at the margins of international trade. LDCs' share of global trade in goods and services increased from 0.57 per cent in 2001 to 0.83 per cent in 2008, and the share of goods alone rose from 0.58 per cent to exceed 1 per cent in 2008 for the first time in many decades. LDCs' share of services trade remains stagnant at 0.5 per cent despite an expansion in value terms. LDC's share of South-South merchandise trade rose from 1.7 per cent to 2.4 per cent during the same time period. Exports of LDCs contracted following the global financial and economic crisis, but they have recently shown some signs of recovery.

LDC's trade performance remains fragile as it is based on a very narrow export base, primarily commodities, which increases the vulnerability of LDCs to external economic shocks. LDCs experience persistent current account deficits during the decade, denoting high dependence on imports for consumption and industrial development. LDCs remain extremely vulnerable to climatic and natural shocks, as exemplified by the situation in Haiti.

The importance of market access for LDCs has provoked a major debate. It was recognized that, although important, market access is not enough. Having efficient supply-side capacity is equally important. There is a need to strengthen the economic resilience of LDCs by way of assisting them in diversifying production and increasing their value added. LDCs should be assisted in producing and trading in sectors/products/services of international trade that show dynamic growth potential and are pro-poor, high income generating and environmentally friendly. Services sector development and trade such as tourism, movement of service suppliers and

IT-related services constitute important drivers for such transformation. Regional integration and South-South trade are especially important to LDCs in helping them diversify their production and markets.

The analysis of LDCs trade also needs to look at the effectiveness of the preferential market access schemes and issues, such as, rules of origin, non-tariff measures and product standards. Flow and composition of Aid for Trade to LDCs deserve special scrutiny, particularly in terms of its contribution to building trade supportive infrastructure.

State of Investment Promotion

The discussions highlighted the important role of FDI for the LDC economies: the share of FDI as a percentage of the domestic investment is equal to some 33 per cent, against some 13 per cent in developing countries on average, and has exceeded bilateral ODA since 2004 to become the most important resource flows to LDCs. However, FDIs are largely concentrated in selected industries and countries. The bulk of it is in extractive industries particularly in Africa and in services and telecommunication in Asia.

There were discussions regarding how much FDI may complement or even substitute the formation of capital by domestically-owned firms. FDIs in the LDCs have been found to also go for mergers and acquisitions, rather than Greenfield investments.

The “crowding in” effect of the FDIs inflows in the LDCs occurs through the fostering of domestic investment, but also through the linkages that are subsequently created with the rest of the economy. It is this dynamism in catalyzing the domestic comparative advantage that increases the benefits associated with foreign investment. The promotion of the linkages between foreign and domestic enterprises has remained a challenge in LDCs. Differences in the effects of FDI on domestic investment among countries suggest that national development strategies and investment policies including linkages between foreign affiliates and domestic firms should be coordinated to ensure maximization of synergies between FDI and domestic investment.

Aside from capital inflows, FDI brings along the benefits of technology, know-how, access to international markets and integration into global value chains led by TNCs. Therefore FDI needs to be more effectively tapped and attracted by LDCs to build up their productive capacities and comparative advantages. However, attracting FDI by small and poor countries has not been easy. In 2008, LDCs collectively attracted less than 1 per cent of the world FDI stock. The domestic legal framework and the bilateral investment agreements have been recognized as being valuable, but insufficient to attract FDIs. Countries need to improve their investment climate constantly for both domestic and foreign investors. Policy-makers need to facilitate linkages with local businesses and nurture their capabilities to take advantage of FDI.

FDI cannot lead economic growth, though it helps countries to grow further. In this respect LDCs could more effectively utilize market-access measures as the EU's Everything But Arms and United States' African Growth and Opportunity Act (AGOA) initiatives. For the LDCs' part, however, it is essential that they build and foster domestic capabilities in physical infrastructure, production capacity and institutions supportive of private investment to strengthen the necessary linkages between TNCs' export sectors and the rest of the economy and be part of their global value chain.

Commodities

Over the past decade, LDCs have become increasingly commodity dependent. This increasing importance of primary commodity exports relative to manufactured exports is the result of the unprecedented increase in the prices of commodities during this period (rather than increases in export volume). This development has therefore exposed their export earnings to price volatility thereby exacerbating their vulnerability. The commodity boom has had differentiated effects on different groups of LDCs. The boom has been beneficial to the net commodity-exporting LDCs (especially those exporting fuels), although it has raised issues regarding the management of the windfall income so that it contributes to sustainable development and poverty reduction. On the contrary, it has created balance of payments problems for those LDCs that are net fuel or food importers. Most of these LDCs have accumulated huge fiscal deficits as a result of the spike in food prices during 2008.

The importance of the agricultural sector in LDCs in terms of its contribution to GDP, and employment, and its potential for poverty reduction was noted, although it was recognized that the sector does not attract resources commensurate with its actual and potential contribution. There was a consensus to devote more resources to the sector in order to increase productivity, efficiency and output.

During the discussions, other issues came up as being particularly important for the LDCs, namely the *problematique* of natural resources, and the importance of good governance to ensure that natural resource rents are well managed. The need to address "market entry" barriers was underscored, in particular because domestic policies for export diversification are less likely to succeed without complementary action at the multilateral level to address these constraints.

Transport, Trade Facilitation, Technology and Innovation

Persistent economic inequality coupled with a lack of access to information, education and training result in an entrenched lack of capacity in many LDCs to absorb, adapt and use science and technology and hence to innovate. Access to ICTs, in particular the number of mobile phone subscriptions, has been one of the most positive developments in LDCs. Unfortunately in other areas such as the broadband internet LDCs still lag behind.

The importance of trade facilitation was illustrated by the case of Benin. LDCs in their efforts to better integrate in the globalized production and trade flows have to strengthen their productive capacity and the competitiveness of their economies and products. To achieve this, the supply chain needs to be improved and costs and time associated with trade transactions reduced.

It was largely recognized that poor infrastructure is a heavy constraint to the growth prospect of the LDCs. Improvements in the infrastructure stock and in infrastructure services are therefore key for LDCs. Improvements should not only cover the building of highways, roads, telecommunication, but also investment in energy and electricity-producing plants. Energy was perceived as being a major, although missing issue, in the debate.

South-South Cooperation

During the past decade, there have been changes in the global scenarios due to emergence of the global South. This global South has become one of the main players with respect to FDIs, merchandise and service exports, technological flows and as a holder of IPRs. Some key countries that belong to this group have moved from being debtor countries into being creditor countries. The LDCs have a lot to gain from exploiting this form of development originating from South-South cooperation.

The discussions in this session led to many questions: Is there adequate understanding of this new South-South cooperation? Is there sufficient transparency? Are they really harmonized in the light of the international best practices in terms of standards that have been established?

Macroeconomic Framework

Although economic growth in LDCs has been strong over the past decade, considerable pitfalls to economic development have prevailed and their effects been amplified by the current global financial crisis.

A much-debated issue has been the various conditions conducive to economic growth in LDCs. In particular, real interest rates have been deemed excessively high in LDCs compared to other developing countries, thereby prohibiting investment and ultimately economic growth. As a rule of thumb, real lending interest rates should equal the rate of economic growth; empirically, however, they would seem to be about 10 per cent too high given this rule. This might be due to market failure and lack of competition in the credit market. Moreover, many LDCs have seen their ability to borrow compromised due to a more restrictive borrowing framework, even though their economies ran on solid foundations. The paramount importance of interest rates for investment was questioned by another panelist. Cross-country evidence was evoked that would show that GDP growth is mostly linked to growth in total factor productivity, a concept which pertains to economic efficiency. Therefore, factors other than interest rates such as the business climate,

political stability and government efficiency, as well as infrastructure might play an even more important role than interest rates.

The panelists concurred on the importance of official development assistance (ODA) for LDCs. There has been agreement that foreign aid will continue to be crucial for some countries, especially in the crisis. In a broader view of capital flows, foreign aid remains the major source of income for most LDCs. The increasing importance of private donors and emerging countries has been highlighted. These emerging donors in particular complement aid flows of traditional donors that have been less active in infrastructure investment in favor of expenditure related to the MDGs. In the discussion, panelists and commentators alike highlighted the need to keep up with ODA commitments to LDCs even in the wake of the crisis which already caused a number of major donors to disburse less. In light of the crisis, the panelist suggested to “getting the analytics right” in order to use scarce development funds in the most effective way.

Major debt indicators of LDCs have improved throughout the past ten years. This can be attributed to the multilateral debt relief initiatives (HIPC and MDRI), which nonetheless soon are coming to an end, and to the commitment of emerging donors at the debt relief front. The panel discussed ways to support LDCs in the issue of debt, for example through debt moratoria, better debt management and better rules for responsible lending and borrowing.

The discussion showed that the crisis has put at risk the achievements in development finance of the previous years. Participants shared country experience on the multi-channel impacts of the current crisis. Accordingly, improved market access for LDCs as well as the preservation of tariff revenue for obtaining fiscal space, have been deemed critical.

Way forward

Admittedly, there is no one solution, just a combination lock, where each country will have to find its unique combination number. Development strategies cannot therefore be conceptualized only at the broad level, but they need to take into account the individual country specificities that characterize each one of them. However, a rigorous retrospective analysis can provide good guidance towards articulating future development practices.

In drafting its report, the UNCTAD Inter-Divisional Task Force on LDC-IV will take on board the comments and suggestions put forwards by the experts at the EGM. The draft will be shared with the panelists in April 2010 for their feedbacks. The Task Force report will provide the substance for discussions by the Member states that are to take place in June 2010 at the executive session of the TDB on LDC-IV. Finally, the document will be fed into the preparatory process for LDC-IV that is being spearheaded by the OHRLLS.

