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Policies for Diversification and Value Addition

By

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The views expressed are those of the author and do not necessarily reflect
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Structure of the Presentation

- Horizontal Policies for Diversification and Value Addition:
 - General Productivity-enhancing measures
 - Fiscal, Monetary and Exchange Rate Policies
 - Competition Policy
- Targeted Policies for Diversification and Value Addition:
 - Addressing Coordination Problems
 - Fostering Market and Value Chain Integration



Horizontal Policies for Diversification and Value Addition



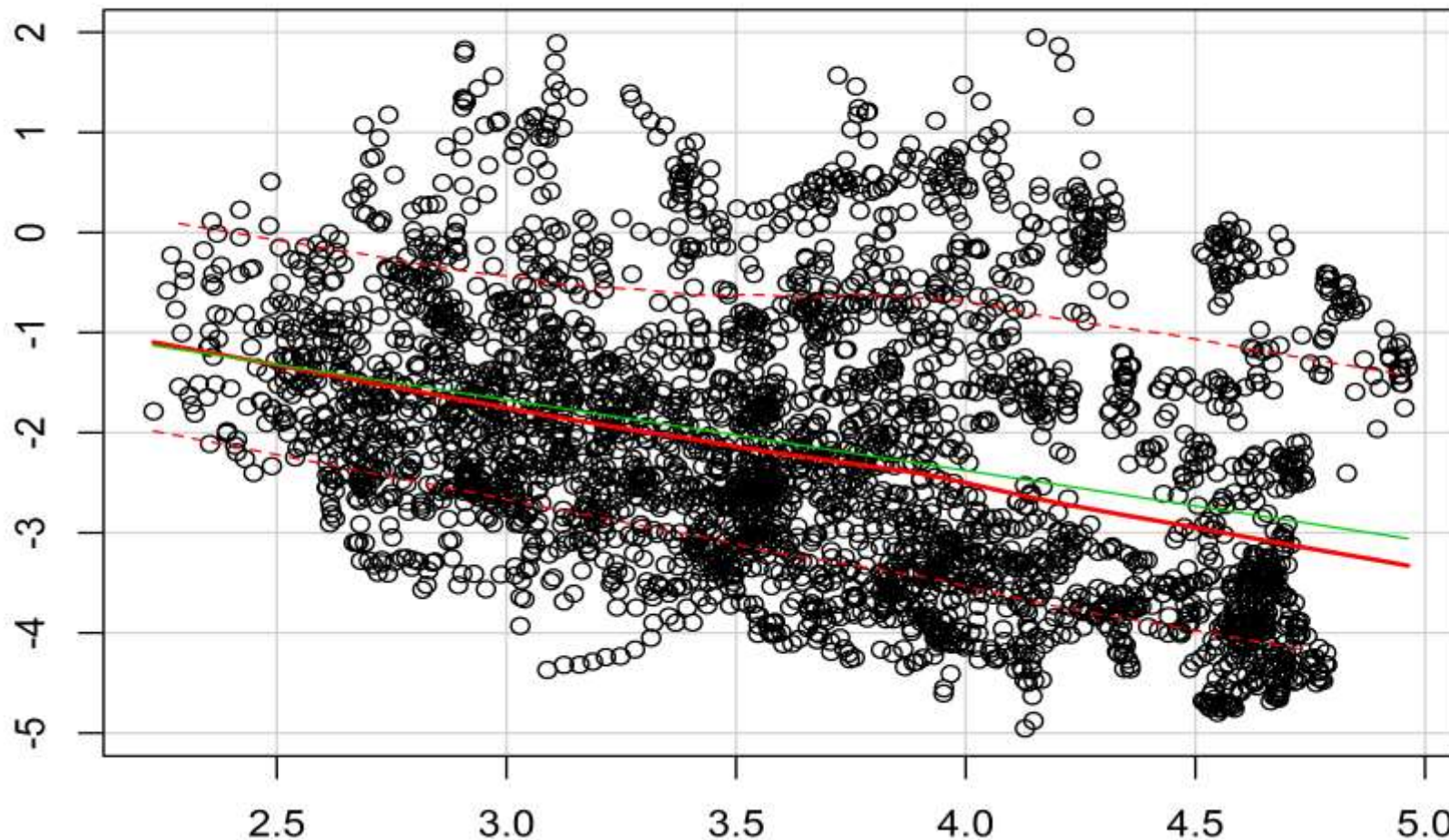
Commodity Dependent Countries are Concentrated

- We discussed the problems of dependency and concentration on **long-term** Development.
- The level of concentration is negatively related to its level of development.
- Also, concentration has **short-term** negative effects on a country's welfare, via volatility.
- Some Horizontal Policies for addressing concentration and fostering value addition also can address directly these negative effects



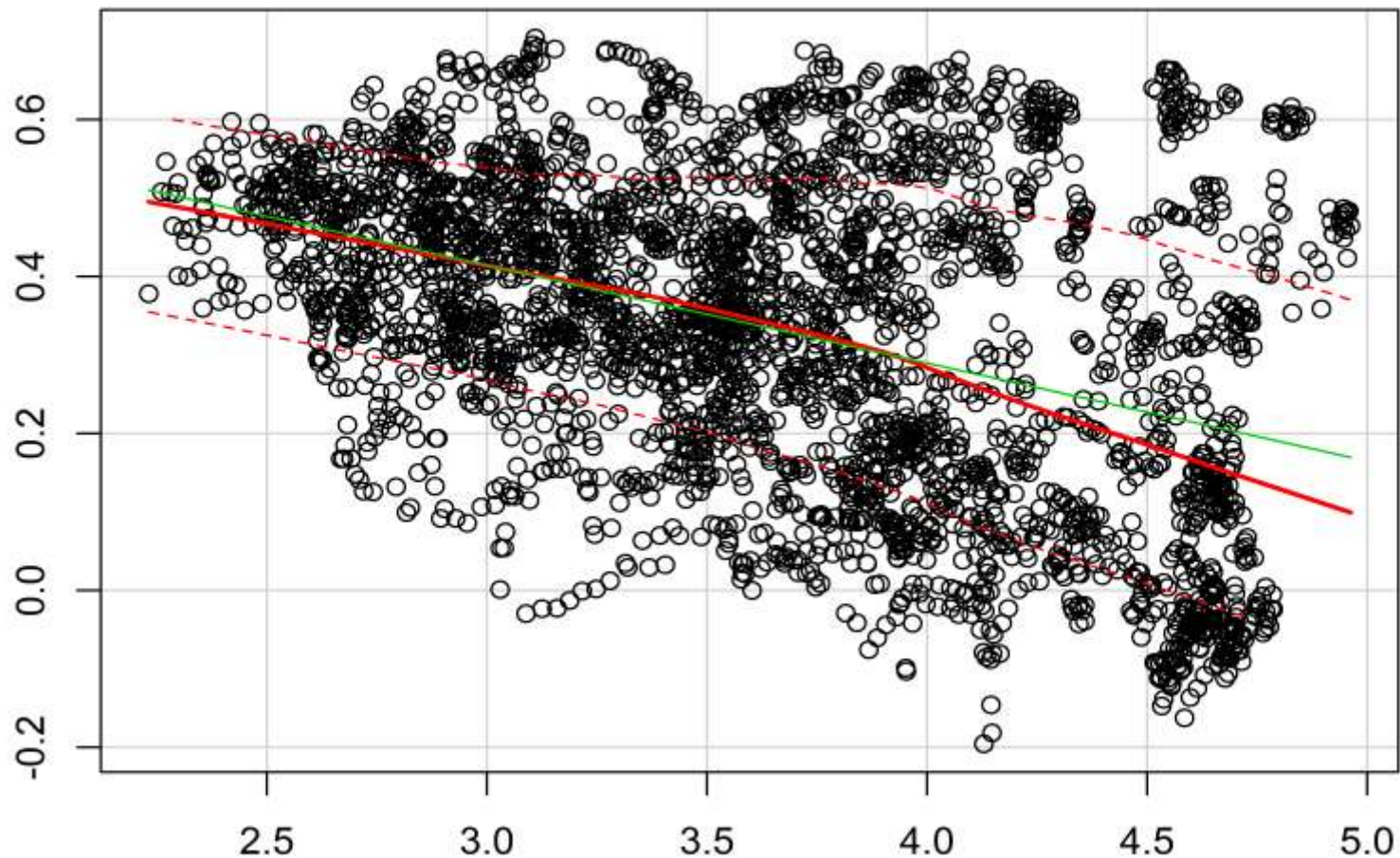
Export Concentration is Negatively Correlated with GDP

Normalized HHI vs GDP per Cápita



...A Robust Finding Using Different Measures

Theil Concentration Index vs GDP per Cápita



Aim: Generate Economy-Wide Favourable Conditions

- Human & physical capital accumulation
- Invest in Science and Technology
- Strengthening of institutions and governance.
- Sustainable use of commodity rents for these three objectives results in a “commodities blessing”.
- Especially important is to strengthen & upgrade:
 - Education, Health and Productive Infrastructure
 - The Rule of Law and Consumer & Investor Rights
 - Government efficacy, efficiency and transparency
 - The ease of doing business and entrepreneurship



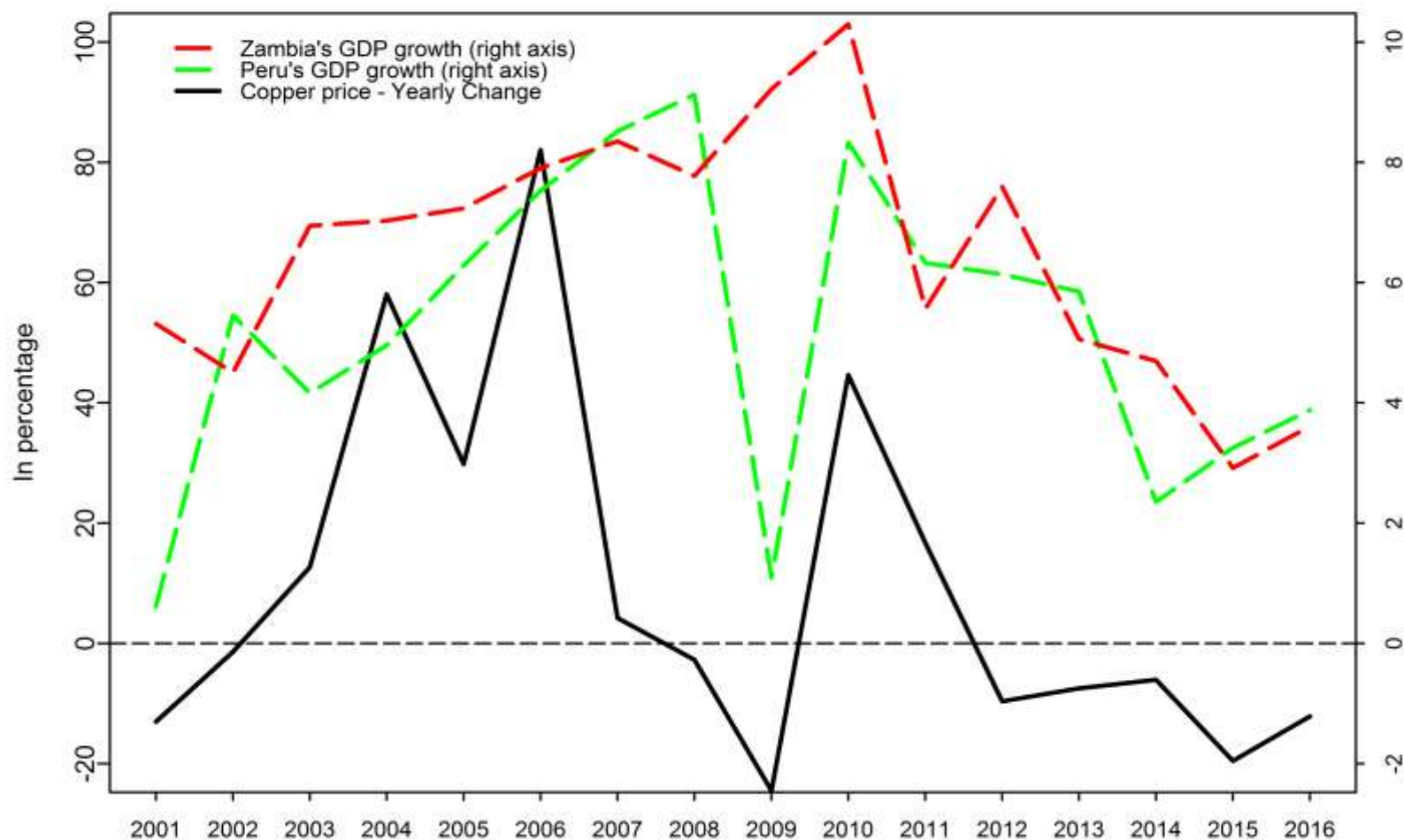
The Need For Sustainable Fiscal Policy

- Facing a **negative** shock, due to budget rigidity public investment is often cut, reinforcing the “stop-go” nature of growth. Self-reinforcing effects of adjustment.
- Public revenue falls exactly when more people become unemployed or informally employed.
- A **positive persistent** shock often leads to unsustainable funding and expenditure patterns.
- Sustainability reduces expenditure volatility from commodity shocks. Essential in countries with narrow tax bases and high commodity revenue dependency.



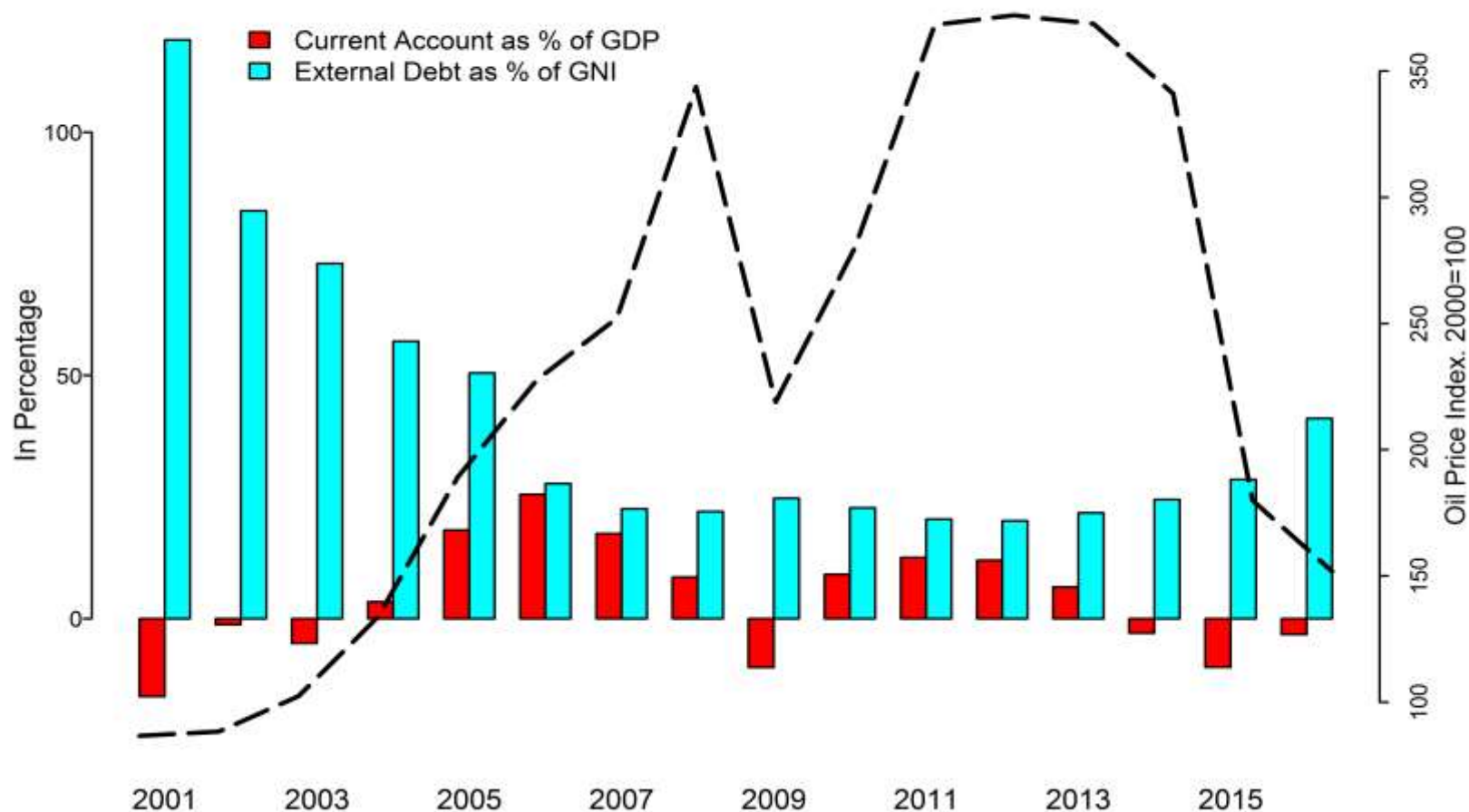
Growth Patterns Often Coincide with Commodity Shocks...

Peru and Zambia - GDP vs Copper Price Growth



Fiscal Results are Correlated with Commodity Prices Too...

Angola - External Debt, Current Account and Commodity Prices



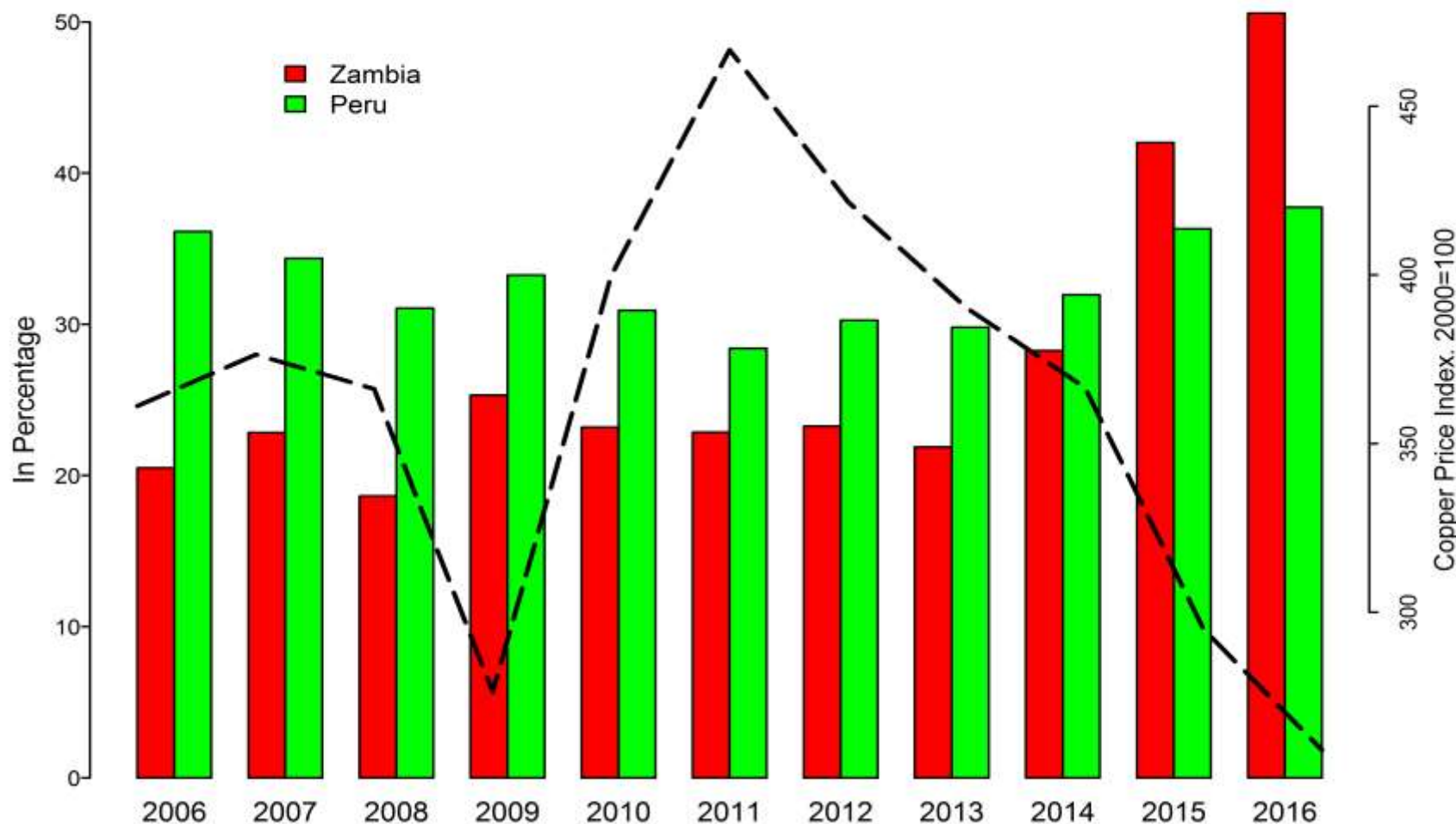
Specific Tools That Can Be Employed:

- Multi-year budgets - planning, transparency.
- Debt and Asset Management - Different types of sovereign funds (e.g. stabilization, inter-generational, pension): self-insurance, social equity; explicit (debt) and contingent liabilities.
- Binding fiscal rules like balance, expenditure and debt rules – sustainability and transparency
- Leveraging public funds for infrastructure with private sector participation, where suitable - increasing expenditure options, maintenance.
- Foster domestic debt markets in local currency.



...And Results Suggest That These Tools Help

Peru and Zambia - External Debt as a % of GNI and Copper Prices



Effective Multi-Dimensional Monetary Policy

- Available only if facilitating conditions exist:
 - Fiscal policy does not dominate monetary policy
 - Sufficient exchange rate flexibility
 - Institutional conditions are adequate, given the objectives fixed by the authorities.
- Increased price and output stability increases expected returns to investment and reduces the risk premium demanded, fostering the former.
- Especially important for investment in new sectors with higher value added, as they are often more vulnerable to volatile conditions.



Consists of Four Different Components

- Attain and maintain a low and stable inflation rate.
- Stabilize the economic cycle in the face of a shock.
- Reduce exchange rate volatility. Especially important for countries integrated into intl. capital markets and indebted in foreign currency.
- Macroprudential policy for Financial Syst. stability .
- Prioritization of the different objectives and their weight on limited policy tools are important challenges faced by CBs.



Exchange Rate Policy: Macro Policy Complementarity

- Flexible exchange rates mitigate but not exclude the probability of persistent overvaluation, especially for financially-integrated countries.
- Preventing persistent overvaluation might require cross-government cooperation: cost of intervention, macro-prudential implications, etc
- Avoiding persistent overvaluation is necessary to foster investment into value added.
- It also reduces the likelihood of unsustainable credit booms, with asset bubbles (e.g. housing)



Competition Policy

- Particularly relevant to lower costs and increase the quality of inputs of goods and services.
- In developing countries with limited resources, it can be seen as a targeted policy
- May be demanding in terms of technical resources, supporting institutional quality (e.g. judicial system) and face competing needs.
- Not to be limited to the competition authority: important role in agriculture to reduce intermediation and increase farmer prices.



Long-Term Benefits of Horizontal Policies Together

- Eliminates induced volatility (from policy).
- Improve diversification policy consistency and credibility, making targeted policies feasible.
- Positively affect investment into new areas.
- More diverse FDI inflows, potentially associated with productivity-increasing technology.
- Increases private interest in infrastructure investment, making possible larger scale/longer-maturity projects.



Targeted Policies for Diversification and Value Addition



Targeted Policies Do Not Operate in the Vacuum

- They require a favourable environment to fructify, and their cost-benefit may be affected.
- In particular, they are vulnerable to institutional weaknesses, so realistic expectations matter.
- They also require:
 - Capacity to identify spillovers and areas of action
 - Effectively determining priorities and timing
 - Dropping failed experiences and learning from them to correct the programme of work



Addressing Coordination Problems

- Important when a sector's capacity to add value or diversify is hindered by up or downstream constraints (e.g. quality inputs, complementary services, access to technology or markets).
- Potential Tools:
 - Fostering FDI in specific areas of the value chain
 - Strengthening business Associations (quality, VA).
 - Supplier support programs.
 - Fostering technology acquisition and diffusion.
 - Provision of specific public goods and services to address bottlenecks.
 - Industry- University cooperation



Fostering Market and Value Chain Integration

- Investors in new sectors or segments of the value chain face uncertainty about future costs and benefits: non-recoverable costs.
- Potential Tools:
 - Export promotion agencies, in particular when working as a nexus with new, demanding markets (packaging, quality control, norms, etc).
 - Rural and Industrial extension services for technology diffusion and value addition.
 - Price Transparency-increasing initiatives



Thank you!

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