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TRADE AND DEVELOPMENT BOARD
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Expert Meeting on the Diversification of Production and
Exports in Commodity Dependent Developing Countries,
including Single Commodity Exporters, for Industrialization and
Development, taking into account the Special Needs of LDCs
Geneva, 26–28 June 2002
Item 3 of the provisional agenda

DIVERSIFICATION OF PRODUCTION AND EXPORTS IN COMMODITY DEPENDENT COUNTRIES, INCLUDING SINGLE COMMODITY EXPORTERS, FOR INDUSTRIALIZATION AND DEVELOPMENT, TAKING INTO ACCOUNT THE SPECIAL NEEDS OF LDCs

Background note by the UNCTAD secretariat

Executive summary

Primary commodities still account for a large share of export earnings for many countries. The Expert Meeting is expected to discuss how the vicious cycle of commodity dependence can be broken and turned into a virtuous cycle of dynamism and development. Diversification and industrialization require several different types of measures addressing the various causes of commodity dependency. For countries dependent on mineral commodities, the central problem is how to channel the income from mineral exports into the building of human and physical capital. In the case of agricultural commodity exporters, diversification involves the identification of dynamic products and markets as well as appropriate policies and actions by Governments and enterprises for entering these markets.

Tariff barriers and tariff escalation, subsidies to agriculture in developed countries and difficulties in meeting the requirements posed by PSP and TBT agreements are among the causes of insufficient diversification in these countries. Agricultural and food markets also pose requirements other than those that are defined in multilateral trade agreements, particularly as regards quality, quantity and logistics. These markets are often dominated by large firms with established brand names, which makes market entry difficult even when market access is assured. Actions that can be taken to overcome challenges of this nature include networking, facilitating the dissemination of information, fostering capacities for quality improvement, improving technical capacities and changing business management.

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INTRODUCTION

1. In many commodity dependent developing countries (CDDCs), particularly least developed countries (LDCs), the commodity sector, which carries the burden for the generation of savings and foreign exchange necessary for development, has not functioned as an engine of growth and industrialization. It is therefore clear that something must change in order to convert the commodity sector into a positive force in the development process.

2. The change that has been observed over the years in those countries that have been successful in their development efforts is that the commodity sector has undergone a deliberate and dynamic transformation and diversification. Through the elimination of bottlenecks and the adoption of appropriate strategies at the governmental and enterprise levels, competitiveness has been enhanced and hitherto unrealized areas of comparative advantage have been identified. Production patterns have changed towards higher-valued and processed products with higher growth rates of demand, both domestically and internationally. Specializing in these products while seeking to graduate to those which generate even better returns has been the essence of successful diversification processes. Successful countries have been able to increase the value added retained in the country and, more importantly, they have been able to plough this into investments for further development and poverty reduction. In the process, diversifying enterprises, which are important “change agents” in an economy, have positioned themselves successfully in global value chains. They have adopted modern business strategies, taken calculated risks and moved to new areas with greater vitality and profitability.

3. When viewed from this perspective, diversification not only generates more investable resources and leads to a reduction in vulnerability to external shocks, but also entails a change in business mentality. This last element is a precondition for successful diversification and also one of the most important factors generating further development. The ability to shift production and exports from customary products to more dynamic ones without losing the expertise obtained in the former is a crucial ingredient for breaking the vicious cycle of dependence and turning it into a virtuous cycle of dynamism and development.

4. The Expert Meeting is expected to discuss what can be done to achieve this break and come up with practical recommendations. A stable economic environment at the macro level, a supportive international trading system and entrepreneurial drive at the micro level are prerequisites but, by themselves, are not sufficient to spur the structural transformation of economies. Governments have to act on certain critical areas, and entrepreneurs have to adopt modern business strategies consciously.

5. For a few single-commodity-exporting countries, however, physical and other conditions may preclude diversification as discussed above. The Expert Meeting is also expected to make proposals on how they can utilize their commodity sectors for development and structural transformation. While many of the requirements are the same as those for other CDDCs, the special condition of those countries could merit some specific recommendations.

Chapter I

COMMODITY DEPENDENCE AND ITS EFFECTS

6. Developing countries as a whole has become less dependent on commodity exports over the last decade. Nevertheless, the number of developing countries that still depend on primary commodities, including fuels, for more than half of their export earnings remained almost unchanged in 1999 – at 88 out of the 145 countries for which data were available. Many countries still depend on a small number of commodities for export earnings: three commodities accounted for more than half of the total export earnings of 61 developing countries in 1990 and of 46 in 1999, of which 22 export mainly fuels.

7. Diversification does not mean that developing countries should neglect their commodity sectors or attempt to increase their non-commodity exports at any price. For some countries, the continued predominance of primary commodities in their export mix may well be the most viable path to increasing incomes and to development of an economy that offers meaningful work and rising levels of welfare to its citizens. While recognizing that each country has its own unique institutions and history, commodity dependent developing countries (CDDCs) can be conceptually divided into four categories along two dimensions: level of development and opportunities for diversification within the commodity sector itself. The problems, priorities and, consequently, the development strategies differ among the four categories.

8. The first category which could be called "*perennial non-diversified commodity exporters*" includes some LDCs and small island States with a large share of total exports accounted for by one or a couple of commodities. Because of small area and/or population and climatic factors, these countries cannot expect to change the situation with regard to commodity production and exports. They may succeed in raising value added by increasing the degree of processing if they can attain the appropriate scale or obtaining a premium for their commodities if the products that they produce are suitable in this respect,[1] or shift out of commodity production into other activities, such as tourism, other services or manufacturing.

9. The second category consists mainly of larger LDCs and non-LDCs deriving a high proportion of export income from commodities, in many cases concentrated in a couple of products. They could be called "*transitory non-diversified commodity exporters*". Several African LDCs fall into this category. They can potentially diversify into alternative areas of commodity production and exports, particularly high-valued agricultural commodities, benefiting from the opportunities that may be offered by international markets. Most of the discussion in the next chapter is focused on these countries.

10. A third category, the "*successful non-diversified commodity exporters*", includes a number of small countries such as Botswana (see box 1) and Mauritius with relatively high incomes where the production of one or a few commodities plays a crucial role in their

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1 In the Windward Island States of the Caribbean, efforts to market organically grown fruit, including bananas and mangoes, have been relatively successful (*Financial Times*, 13 November 2001).

economies. They face limits to the broadening of their commodity exports for reasons similar to those regarding the countries in the first category. They also remain exposed to external shocks resulting from changed market conditions for their commodities, and, given the usually small size of their economies, such shocks can have a dramatic impact on their development.

11. The fourth category, "*diversified commodity exporters*", comprises larger, medium- and high-income developing countries with relatively diversified economies but where commodity exports play an important role in the development process, particularly with respect to poverty reduction. The economies of these countries are less exposed to the vagaries of commodity markets, but the prospects for economic growth are influenced by developments with respect to demand and market access conditions for their commodities. Moreover, large segments of the population of these countries, particularly in rural areas, depend on commodity production and exports for their livelihood. Poverty reduction in these areas is often intimately linked to productivity growth in the commodities sector. This group includes mainly Asian and Latin American countries and some particularly successful African countries. Their objective would be to reinforce the positive contribution that the commodity sector has made to development. Their experience provides useful guidelines for commodity dependent countries intending to diversify.

12. A significant number of CDDCs, mainly among the perennial and transitory non-diversified commodity exporters, depend on products with slow growth and negative price trends.[2] As a result, domestic saving and investment remain low and the countries lack revenues and resources for development and diversification. Moreover, these countries experience large fluctuations in export earnings, normally for reasons beyond their control, which lead to macro and micro instability, higher risk premiums and further reduced generation of savings. Consequently, these countries are unable to make the investments in infrastructure, human resources development and institutional capacity building that are necessary prerequisites for diversification.[3] It should be noted that there may be "newcomers" producing the same products, but they normally do not depend on the commodities in question and have diversified into these products as an economic choice, and often under the guidance of, and with assistance from, international financial institutions.

13. In the exporting countries themselves, particularly among the transitory non-diversified exporters, institutional factors such as insufficient market information, lack of access to technology and inputs, lack of extension services, difficult access to finance, and lack of organization and cooperation among domestic firms pose formidable barriers to diversification. For example, most of the food production in many developing countries is for

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[2] According to UNCTAD secretariat calculations, if coffee prices had remained at the level at which they were in 1998 (when they were, historically speaking, at an "average"), developing countries would have earned an additional export income of almost $12 billion over the three-year period 1999-2001, and $6 billion in 2001 alone.

[3] See The *Least Developing Countries 2002 Report* for a detailed discussion of the relationship between poverty and dependence on one or a few primary commodities for export earnings.

subsistence. Increased specialization in cash crops necessitates skills, inputs and risks that the farmer cannot afford.

14. Obstacles to diversification are also found in the international trading system. These include formal barriers to market *access*, and subsidies and support to agricultural production and export in industrialized countries. Barriers to market *entry* in importing countries are also important. These include oligopolistic market structures and quality requirements. In addition, oligopolistic markets often lead to increasing gaps between international prices and consumer prices, and to the benefits of productivity improvements being appropriated largely by intermediaries and/or consumers.

Box 1

A successful non-diversified commodity exporter: Botswana

The economic growth experience of LDCs dependent on exports of mineral commodities is by and large disappointing. Several explanations have been put forward, including "Dutch disease" type phenomena, where surges in mineral export revenue lead to appreciating real exchange rates and consequent lack of competitiveness in other tradables sectors, and problems of governance. It is nevertheless recognized that mineral exports have a powerful potential to serve as a base for rapid growth and economic diversification. An illustrative example is provided by the only country to "graduate" so far from LDC status, Botswana.

Botswana has three major mineral resources: diamonds, copper/nickel and soda ash, of which diamonds are by far the most important in economic terms. Diamond mining started in the early 1970s and Botswana became a significant producer after 1982 when a major mine was opened. While there are few links between mining and other economic activities, income from diamond mining, both in the form of taxes and dividends, has accounted for about half of government revenues over the years.

The Government of Botswana has followed a consistent policy in attempting to optimize the contribution of mineral income to development and avoid macroeconomic imbalances. Six types of policies have been particularly important in this regard:

(1) Limits on the growth of government spending were established and, generally, observed.
(2) The exchange rate was closely linked to that of the South African Rand, since South Africa accounts for about three quarters of Botswana's imports. The gradual depreciation of the Rand against major currencies is deemed to have been a positive factor for Botswana's competitiveness.
(3) Mineral income was "sterilized" through the build-up of very large foreign exchange reserves.
(4) The development of large wage differentials between the mineral sector and other parts of the economy was prevented through an incomes policy.
(5) The Government invested heavily in human capital.
(6) Particularly in recent years, Botswana has encouraged foreign investment not only in mining but also in other sectors through taxation and other measures designed to attract investment.

During the period 1984/85 to 1998/99, GDP per capita in Botswana increased at an average rate of 4.3 per cent, faster than in any other country in the world. Non-mining GDP per capita increased at an average rate of 6.7 per cent. Formal employment increased by 5 per cent per year. It may merit mentioning that Botswana ranked 26th on the 2000 Corruptions Perception Index prepared by Transparency International, highest of all African countries and second highest of developing countries.

Source: Modise D. Modise, “Management of mineral revenues: the Botswana experience”, paper presented at UNCTAD Workshop on Growth and Diversification in Mineral Economies, Cape Town, South Africa, 7–9 November 2000.

15. Economic and institutional *exit* barriers may also pose obstacles to diversification. These include sunk costs in current activities (for instance, trees with long gestation periods) and lack of skills in producing and marketing alternative products. Social and political factors in CDDCs may also thwart diversification. For instance, political institutions may be under the influence of the dominant sector and financial and technical assistance is often directed towards this sector. Finally, macroeconomic factors may place important stumbling blocks on the road to diversification. Debt burden and devaluations favour increasing the production and exports of the traditional product because it is easier to do so in the short to medium term. Insufficient infrastructure, particularly as regards both cost and availability of transportation and storage, is especially important for some countries and for some products that have high potential in world markets, for instance fresh fruit and vegetables.

Chapter II

AVENUES FOR DIVERSIFICATION AND POLICY OPTIONS

16. In this chapter, international and domestic problems that hamper the diversification and industrialization efforts of commodity dependent countries, as well as policies and actions that could be implemented by Governments and the enterprise sectors, are reviewed.

17. Diversification and industrialization require a plethora of measures at different levels. A stable and predictable macroeconomic and political and regulatory environment, as well as a fair and open international trading framework, are among the basic requirements of the development process. The question posed to the experts, however, is what specific policies and actions, apart from these basic requirements, would be necessary for the diversification and industrialization efforts of commodity dependent countries.

A. Problems stemming from the international trading system

18. For agriculture, the main achievement of market access discipline achieved in the Uruguay Round was "tariffication", a process through which non-tariff barriers such as import bans and quotas were set as specific tariffs often with high *ad valorem* incidence. However, some of the new tariffs were set at extremely high levels. Six years on, with Uruguay Round implementation in agriculture completed for the developed countries, tariffs remain high. Average most-favoured-nation (MFN) agricultural tariffs in the OECD countries are around 60 per cent, whereas industrial tariffs are rarely above 10 per cent (other than for textiles and clothing).[4] Most of the tariff peaks are in agriculture, including processed products.[5] Moreover, agricultural tariffs are sometimes very complex and include seasonal variations. Market-opening measures in the form of tariff-rate quotas (a quantity of imports allowed at a lower tariff) have not been completely successful, with a large number remaining unfilled. Finally, although developing countries have been accorded preferences under a multitude of agreements,[6] exceptions to these preferences often relate to agricultural products. For example, the European Union's initiative on "Everything but Arms" (EBA) offers free market access to LDC products, with less than 5 per cent of pre-EBA exports left facing a tariff barrier. According to simulations however, the impact of this initiative will be a relatively small increase in exports from the LDCs, as 70 per cent of the potential positive

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4 Brooks, Jonathan and Cahill, Carmen. Why agricultural trade liberalization matters. *OECD Observer*, 26 October 2001, p. 44.

5 As far as exports of mineral commodities are concerned, both tariff and non-tariff barriers have limited impact on international trade. Nevertheless, there have been a relatively large number of anti-dumping cases dealing with metals.

6 The "unbound" nature of these preferences is a major shortcoming from the point of view of providing long-term security for investors.

trade effects would have come from free access for sugar, rice and beef, which has been deferred until 2006.[7]

19. Owing to the existence of various preference schemes, the importance of tariff barriers as an impediment to diversification and industrialization varies among different groups of countries. While those countries without preferences would seem to be those that gain most from improved market access conditions, those enjoying important preferences are concerned about losing their preferential margins. A review of experience shows, however, that preferential tariff margins alone have not been the determining factor in most success stories. A significant liberalization is likely to lead to more fundamental gains than maintaining preferential margins.

20. One of the consequences of preferences enjoyed by the African, Caribbean and Pacific (ACP) countries has been an increased dependence on the European market, reducing even further the geographical concentration of exports. These countries have not benefited as much as exporters in other regions from the expansion in demand in other parts of the world, such as East and South-East Asia, which have been the most dynamic impact markets for commodities. The proportion of their exports to Europe has increased while the importance of Europe as a destination has decreased for all others. While this may indicate that preferences have worked, it also implies that important opportunities have been bypassed. The African Growth and Opportunity Act has started to open up markets in the United States for African countries.

21. In many countries the processing of commodities, particularly agricultural products, has been the basis of industrialization. The tendency for tariffs to escalate according to the degree of processing, however, makes this process more difficult than it would be otherwise. Tariff escalation biases exports towards unprocessed resource-based commodities, characterized by low value-added. Tariff escalation is more pronounced in cases where the raw material is not produced in the importing country. As a consequence, in developed country markets processed forms of tropical products such as coffee, tea and spices, as well as some fruit and vegetables, are affected disproportionately by tariff escalation, and local processing of these products is discouraged particularly strongly. With few exceptions, post-Uruguay Round tariffs escalate not only between raw and semi-finished but also between semi-finished and finished items, thus impacting on the more advanced stages of industrialization more strongly. Here again, preferences play an important role, and it could be argued that those countries whose exports enter duty-free owing to various preferences do not face this bias. In reality, these countries may be in a better competitive situation than those facing the escalating tariffs, but not in relation to the processing industry in the importing country. The latter enjoys effective protection in so far as some of the processed imports into the country are subject to an import duty.

22. Subsidized exports from developed countries affect both domestic and international markets and exert a negative influence on the diversification of production and exports from

[7] UNCTAD and the Commonwealth Secretariat. Duty and quota free market access for LDCs: An analysis of Quad initiatives, UNCTAD/DITC/TAB/Misc.7, London and Geneva, 2001.

commodity dependent countries. Loss of competitiveness caused by subsidized agriculture discourages investments in agriculture and local processing in non-subsidizing countries. Although urban consumers may enjoy access to cheaper food products, there are abundant examples of developing countries' products being displaced on domestic markets by imported ones from developed countries providing generous subsidies, and export markets being lost to suppliers from the same countries. "Coherence" in the approach to agriculture and the elimination of inequalities in agricultural trade rules would provide an important contribution to generating international trade based on comparative advantage. This would eliminate important constraints on embarking upon industrialization and growth paths with a strong contribution from a diversified agricultural sector, where many developing countries have a comparative advantage.

23. Another feature of the Uruguay Round concerning agriculture was disciplines on domestic support, which has strong impacts on international trade. Countries agreed to reduce the more trade-distorting support measures (such as output-related price supports), but not the less distorting ones (such as direct income payments). These commitments, however, have not significantly constrained the use of such measures by WTO members (almost exclusively developed ones) since it was agreed to make reductions from a base period of unusually high support. Several countries have also shifted to less distorting support measures which, nevertheless, help to keep productive resources in farming and, as a result, continue to affect trade. In this respect, further reductions and stronger disciplines on existing support should have a beneficial effect on developing countries' exports. Meanwhile expanded possibilities for support by developing countries, particularly in the context of a "development box", are being proposed. The financial means to provide domestic support, however, is lacking in most commodity dependent countries, particularly LDCs.

24. Significant improvements in market access will require, apart from a sharp and meaningful reduction of subsidies, much deeper cuts in tariffs, or big increases in the volumes admitted at lower tariffs, preferably both. Elimination of other trade barriers and trade-distorting practices is also instrumental in this respect. Other issues that need to be addressed in the context of further liberalization of world trade include the potential for State trading enterprises to distort trade, the overwhelming market power of some large companies, the growing use of anti-dumping duties, and the possible misuse of food aid and export credits. The burden of liberalization on net food-importing countries and specialized exporters that depend on one or two key commodities also needs to be addressed.

25. Significant flexibilities should be provided for the most vulnerable developing countries such as LDCs and single commodity exporters (SCEs) to decide what products would be subject to commitments, the commitments they would make and the rules and disciplines that would apply. The specific measures should also take account of special difficulties faced by commodity dependent countries such as depressed commodity prices, and large price volatility. Better conditions for transfer of technology and the design of rules (similar to those that apply to State trading enterprises) for private corporations with huge market power are among the measures proposed. Trade-related technical assistance, which now appears to be an accepted commitment by developed countries, should aim not only at

the negotiation or implementation of WTO agreements but also at supporting diversification efforts and developing supply capacities for benefiting from opportunities offered by the new trading framework.

26. The difficulties faced by developing countries, particularly LDCs, in the implementation of some agreements, such as the Agreement on the Application of Sanitary and Phytosanitary Measures (the SPS Agreement) and the Agreement on Trade-Related Aspects of Intellectual Property Rights (the TRIPS Agreement) also create significant problems. The standards and processes (such as the Hazard Analysis Critical Control Point System) related to the SPS Agreement threaten to turn into the most important barriers against developing countries' agricultural exports. Concerning the TRIPS Agreement, agricultural producers in exporting countries without sufficiently developed infrastructure for intellectual property protection risk losing markets because importing firms fear that "illegally" produced or obtained seeds may have been used in production. However, it is not particularly useful for developing countries to seek exemption from or a weakening of the multilateral disciplines since this would erode consumer confidence in their exports. The best way out for weaker economies is to insist on capacity-building before the implementation of agreements. In this light, improved technical and financial assistance for ensuring traceability and meeting SPS and technical barriers to trade (TBT) related standards, and for TRIPS compliance, is among the most important needs of these countries.

B. Meeting the requirements of international markets

27. Many reasons apart from international trade measures are responsible for the inability of developing countries, especially LDCs, to benefit from existing opportunities in international markets of fresh and processed agricultural products. Among the main reasons are quality and quantity inadequacies and difficulties in entering markets dominated by large firms which are often owners of well-known trademarks. Solutions to these problems lie outside the realm of multilateral trade negotiations.[8] With markets becoming more demanding, there is a need for policies and concrete plans of action that give the leadership role to the private sector, but with the public sector playing an important enabling role. Strategies with priorities in terms of geographical and product markets should aim to pave the way for latent comparative advantage to be converted into actual competitive advantage for exporters.

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[8] The following discussion makes ample use of the findings of the project on "Capacity building for diversification and commodity-based development" implemented by UNCTAD. Agriculture, and in particular the horticultural sector, has been the main focus of the project but problems of the mineral dependent countries as well as issues related to fisheries and forestry sectors have also been addressed. The project aims to assist developing countries efforts towards horizontal, vertical and geographical diversification of production and trade structures. A total of seven regional and subregional workshops (three for Africa, one each for Central America, Asian LDCs and transition economies, Pacific island countries, and Central Asian countries) and five national workshops (Cuba, Gambia, Mauritius, Nigeria and Peru) stemming from the recommendations of the regional and subregional workshops have been organized. Several others are in preparation. For further information, consult http://www.unctad.org/infocomm/Diversification

28. Globalization and liberalization may reinforce traditional relations of dominance between firms in developed and developing economies. For example, developing countries entering the soluble coffee business find themselves competing directly with two of the world's largest food companies, and there are large and powerful firms in the fruit and vegetable business, particularly in the processing and distribution stages. Developing countries' enterprises need to compete against the technical efficiency of these firms and also their financial, political and market power. This is a particularly difficult feat for enterprises in LDCs and other small countries, which include many SCEs. At the same time, if appropriate and mutually beneficial links are established, firms in developing countries may find more ample and potentially profitable points of entry to, and scope for effective participation in, international value chains for commodities. In doing so, possibilities are increased for diversification and industrialization.

29. The entry of producers, processors and traders into the chain, however, depends not only on the aspirations of interested firms but also on the characteristics of the product, technical requirements, market structures and the organization of trade. The capacity to upgrade and produce according to specific requirements relating to quality, health and the environment, as well as consumer preferences and tastes, is the determining factor. Enterprises can attain a favourable bargaining position if they have the capacity for product and process innovation, and access to an especially competitive supply, and can generate economies of scale. Transition to specialized and differentiated products, if possible through the establishment of internationally recognized brand names, or to niche products, and vertical diversification could allow the enterprises of these countries to have a bigger say in the commodity chain and attain higher revenues, as well as price and revenue stability. The challenge is to identify the opportunities, recognize the requirements and respond to them. As comparative and competitive advantages change over time there is a constant need to look at diversification opportunities, even away from areas that seem very successful, into other dynamic high-value products.

30. Extending the range of processing undertaken by local companies to prepare fruit and vegetables is one opportunity for adding value to exports and entering manufacturing activities. Whilst canned vegetables consumption is in decline, there are growing markets for cooked, preserved vegetables, pickles and frozen vegetables. Concerning new products, some tropical fruits and flowers, speciality vegetables such as mangetout and babycorn, gourmet coffees and partially dried fruit have found strong demand in developed countries and provide greater returns to developing countries than their traditional exports. The story of kiwi fruit (box 2), in particular the response by New Zealand exporters to growing competition, illustrates some of the dynamics of a new product on the international markets. Recent developments show that alternative routes for adding value to horticultural products have emerged. These include preparations undertaken locally, such as packaging, bar-coding and arranging ready-made bouquets. These activities not only create employment in the producing countries but also make the product ready for the consumer without a delay in the importing country and add value through freshness. One of the important features of these value-adding activities is the prominence of women workers.

Box 2: Reconfiguring the kiwi fruit

The kiwi fruit originated in China as the Chinese gooseberry, but New Zealand growers who introduced the new name in 1959 achieved its commercialization on a global scale. It is reasonably easy to grow, and competition has expanded. By the early 1990s, the largest exporter was Italy, whose production grew to 262,000 tonnes in 1998 (as against 240,000 tonnes in New Zealand) and to 330,000 tonnes in 2000. Chilean exports were also entering the market on a global scale, with production growing to 156,000 tonnes in 1998. Not surprisingly, global prices have been declining. Given that it is New Zealand's single largest horticultural export, this represented a real challenge for New Zealand growers.

Their response was to develop:

- A new, gold-coloured variety, ZESPRI™ GOLD. Marketing began in Asia in 1998, emphasizing the fruit's health properties, linking it to roller-board displays in large supermarkets and aerobics in smaller stores. The New Zealand Marketing Board has copyrighted the variety, and organized contract growing in four Italian cooperatives.

- New varieties of organize kiwifruit (also copyrighted as ZESPRI™ GREEN) are being marketed at a premium price, with exports doubling in 1999.

"It is an excellent product: after 25 years selling traditional green you don't know how exciting it is to sell something different" (quoted from a European marketing manager).

Source: Kaplinsky, R. and Fitter, Robert. Who gains from product rents as the coffee market becomes more differentiated? A value chain analysis, *University of Sussex, IDS Bulletin Paper,* May 2001 (forthcoming), http://www.ids.ac.uk/IDS/global/pdfs/productrents.pdf (quoted from *Financial Times* 17 August 2002, and www.zespri-usa.com).

31. In CDDCs, particularly LDCs, where small and medium enterprises prevail, Governments have a critical leadership and facilitating role in many areas such as quality control, technological upgrading and promotion of linkages with foreign firms. Business associations can assist in embarking upon value-adding activities by undertaking market research to help in identifying emerging trends. Governments and international organizations can also provide assistance in this regard. Close and cooperative business networks within vertical supply chains and horizontal ties with other producers can help firms, especially small enterprises, in responding rapidly to new orders and market developments, and ensure that they do not lose existing orders. Development of credible national "codes of good practice" by business associations in exporting countries can help in entering and maintaining markets.

(i) Networking

32. Small enterprises are common in most commodity dependent countries. Networking and acting in groups through sharing of information, and cooperation in the design, production, marketing and provision of after-sales services play a central role in overcoming the scale problem. These relationships lead to learning by interaction and seem to be more adapted to the new characteristics of competition based on quality, speed and innovation. They can also reduce overhead costs by mutual implementation of contracts, joint purchase of inputs, jointly funded ancillary services or joint marketing initiatives. These relationships can, and whenever relevant should, also involve processing firms. In such cases, the establishment of desirable linkages between the agricultural and industrial sectors as well as related service sectors is significantly facilitated. This may enable branching out into the production of the equipment or inputs required for harvesting, mining or processing, develop technologies and, eventually, lead to exporting these along with the initial commodity. Furthermore, clusters of SMEs can facilitate efforts by Governments or business associations to provide assistance and to foster partnerships between foreign and local firms.

(ii) Facilitating the dissemination of information

33. Access to information on supply and demand as well as on consumer specifications and preferences is necessary for developing and maintaining a competitive market presence. But it is costly. It requires presence in, or at least close contacts with, the market place. For many entrepreneurs in developing countries, the lack of information constitutes an acute problem that prevents them from prospecting external markets and benefiting from niche markets, especially for new products. In this respect, gathering and disseminating information is essential. A way of increasing firms' awareness of market situation is for Governments to help in the collection, and encourage the sharing, of information among local firms. Equally, joint ventures with enterprises in the more advanced export markets, or with manufacturers that have achieved a successful level of business, could offer a way of overcoming the extremely high costs of obtaining up-to-date information. Ethnic links with the importing countries can also provide a positive contribution, particularly in the initial stages of market penetration.

34. Market information systems accessible at the local level need to go beyond simply supplying information on prices: they should also provide information on availability and the cost of support services, potential markets for exports, and procedures and other requirements for exporting products. In order to increase the bargaining power of small producers, this information should be regularly disseminated to them both through their associations and directly. Adequate means to reach widely spread and distant farmers (including through radio, TV and telephone networks) are crucial in this respect. The idea of financing the appropriate hardware as a cost-effective means for reaching a wide audience could be explored. Introductory training programmes for small farmers, possibly through their associations, to enable them to benefit from information technology would be of considerable help.

(iii) Fostering capacities necessary for quality improvement

35. Improving the quality of exports is vital for increasing competitiveness in international markets and for a successful diversification of export structure. In fact, quality consciousness generates a culture that is a precondition for embarking upon an industrialization drive. A combination of measures, including special training programmes for production, management and marketing, is necessary in this respect. Understanding and meeting internationally accepted standards is the first step in this direction. Apart from Governments, regional standardization institutions such as the African Regional Organization for Standardization (ARSO) can contribute to actions in this regard both nationally and regionally.

36. For a successful diversification effort, the step beyond improving qualities is the identification and development of new products. Importers are always looking for new ideas from exporters. Partnerships with foreign corporations with more experience in the area of research and development aimed at enabling the adaptation of foreign techniques to local needs, the design of new techniques to match local conditions and the testing of new export products are of the utmost importance in the pursuit of diversification.

37. At the national level, education and training require adaptation to these needs. Apart from improving capacities for managing diversification policies and training of planners and policy makers so as to give them an in-depth knowledge of existing channels and axes for possible industrialization based on diversification and the factor endowments of the countries, there should be a special focus on research and development with a view to promoting as well as disseminating and adapting innovations.

(iv) Technical and technological capacities

38. The establishment of partnerships between local and foreign companies in the mineral and agricultural sectors seems to be the shortest way to improving technological capacities. This includes FDI, joint ventures, licences, management contracts, subcontracting and franchising. Uruguay Round Agreements have changed conceptions and orientations concerning technology transfers, including laws governing intellectual property rights, and made this a more complicated matter, increasing the attractiveness of partnerships.

39. One of major avenues for export is the production of outputs of desired qualities and quantities on the basis of contractual arrangements with large supermarket chains or transnational corporations (TNCs). While TNCs were instrumental in starting new activities in the old days through direct production, this is now often done through contract farming under which meeting and maintaining quantity and quality standards set in the contracts, often with crucial assistance from buyers, is the main element. Contract farming may provide lower returns at times of transitory high prices but stable prices over a relatively longer run. This situation may be preferable, especially for small and medium-size producers.

40. Owing to the flexibilities provided to LDCs and other developing countries under WTO agreements, Governments in these countries could also identify alternative ways of encouraging the enterprise sector to gain access to technology and know-how. In this context, although government resources are limited, support could still be provided through the availability of good equipment for research, including laboratories, and the establishment of scientific review bodies.

(v) Business management

41. Improved business management practices are important not only for success in entering new commodity markets but also for industrialization. In fact, business skills needed for producing and exporting high-value and differentiated products are much more similar to those needed for industrial products than for traditional bulk commodities. Such skills call for much closer links than before between the trade and production levels.

42. Major changes are reshaping management of agriculture and agro-industry in five fundamental areas. The *first* of these is the application of business principles and manufacturing approaches to agriculture. This is transforming farming from a rural lifestyle to a business. This means that farms have to use procurement, inventory management and process control techniques similar to those used in manufacturing industries. As this is much easier in larger farms, small producers have an interest in entering into cooperative or cooperational arrangements among themselves or with processing and trading firms, or lose out and be taken over by larger ones, possibly international concerns. The *second* area is environmental controls and regulations, which often result when the public (in the producing or importing countries) perceives that the commodity sector (both agriculture and mining) has the potential to produce significant pollution. These regulations influence what, where and how production is done and require the adoption of methods that reduce pollution. Precision production is the *third* major area of change. Increasingly, and in order to meet purchasers' requirements, such as for traceability, farmers use advanced science and technology to monitor the production processes and adopt technology and management practices to standardize and control the process of production. The *fourth* area is the development of differentiated products that move farming from producing commodities to producing products with specific attributes for specific end uses. Differentiation may be considered as a viable strategy for products where this is technically feasible and identifiable by the client.[9] Naturally, the returns of differentiation accrue to that stage of the chain which is responsible for the differentiation, and it does not necessarily mean, particularly in oligopolistic markets, that a large part of the benefits accrues to producers. Differentiated products require segregation and identity preservation during the whole value chain. This is a major challenge in the *fifth* area, namely distribution systems, where important changes are under way and supermarket chains are increasing their prominence in world markets. The traditional distribution systems, structured to handle large volumes of bulk commodities, need to be adapted to dealing with differentiated, high-value products.

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[9] For mineral commodities, there is little scope for differentiation and developing countries can compete on near equal terms with developed countries.

43. Concerning differentiation, instant coffee prices in United Kingdom supermarkets vary, according to type (powders, granules, quality and speciality) and brand, between £0.35 per 100 grammes and £3.09 per 100 grammes. Some of this difference may be attributed to processing costs. The prices for roasted ground coffee, where differences in such costs are likely to be much smaller, also show considerable variations and range from £0.57 per 100 grammes to £1.60 per 100 grammes.[10]

44. Two special types of differentiation, requiring certification by independent bodies, concern organic and "fair trade" markets. Organic products obtain a higher price owing to their production without chemical inputs. In fair trade, consumers are targeted who are prepared to pay a premium to ensure that producers get a "fair" price. In this case, guaranteed minimum prices considerably higher than those on the market are paid to farmers meeting certain special sustainability conditions, especially in poor countries. These prices are also guaranteed over a relatively long period.

Box 3: Exporting cut flowers from Ethiopia

Company: Meskel Flowers was incorporated in 1992 as a private company, and started to export cut flowers to European markets in 1993.

Performance: The company had to overcome many problems in the early years, but has now achieved a solid base from which it is planning to expand rapidly. It started by exporting low-value outdoor summer flowers, but decided to switch to relatively high-value indoor cut roses after facing crippling competition from Kenyan exporters. It currently exports 5.5 million cut roses per year (with a value of $1 million), and has 500 employees. Turnover is expected to quadruple to $4 million in the present season, and the company has plans to reach $20 million in five years.

Key success factors:
- The founder spent 10 years in the United States before returning to Ethiopia with a clear idea of the business he wished to develop. He was inspired by Kenya's cut flowers success story, and was assisted by visits to the International Finance Corporation (IFC) in Washington DC, the International Trade Centre (ITC) in Geneva and the Centre for the Development of Industry (CDI) in Brussels. As a result, he developed a clear idea of the factor for success in terms of the market's requirements;
- Market responsiveness as illustrated by the switch from summer flowers to roses in the face of competition;
- Feasibility studies by the African Project Development Facility (APDF) in Nairobi helped secure finance, and technical assistance from the CDI was instrumental in

[10] Kaplinsky, R. and Fitter, Robert. Who gains from product rents as the coffee market becomes more differentiated? A value chain analysis, *University of Sussex, IDS Bulletin Paper*, May 2001 (forthcoming), http://www.ids.ac.uk/IDS/global/pdfs/productrents.pdf

achieving success.

Constraints: The company was established at a time when Ethiopia was striving to move from a centrally planned to a free market economy. The company was born in a period of massive change and uncertainty. New laws and regulations were being introduced, but the business environment remained difficult for private companies. Current constraints include import restrictions for certain chemicals and fertilizers, which expose production to disease and yield losses. The shortage of aircraft freight space and domestic road transportation has also caused significant problems.

Source: UNCTAD, *Investment and Innovation Policy Review, Ethiopia*, UNCTAD/ITE/IPC/Misc. 4, New York and Geneva, 2002, pp. 71-72.

(vi) Physical infrastructure

45. The difficulties generated by telecommunications and transport problems are of crucial importance. Exorbitant transportation costs affect the competitiveness of many developing countries, especially some small island States and landlocked countries. In Uganda, for example, 70 per cent of the value of exports has gone into transportation and insurance payments. This is an extreme case. But it is not unusual in Africa for as much as 40 per cent of national export earnings to be diverted into international transport services. In the United Republic of Tanzania, transport costs account for 60 per cent of the total marketing cost for maize, and losses due to inadequate storage facilities are estimated to be 30-40 per cent of production.[11]

C. Financing of diversification

46. Financing of diversification in terms of both foreign exchange and domestic savings is a major constraint faced by most commodity dependent countries. Enhanced debt relief and a substantial increase in development assistance would help in both areas. Measures aimed at promoting foreign investment and the efficient utilization of financial assistance are also of special importance.

47. Regarding foreign exchange, debt service payments absorb a major part of revenues, thus reducing capacity to import capital goods and necessary inputs. At the same time, not only has official development assistance remained below internationally accepted targets but also its share going to agriculture has declined. Moreover, FDI inflows into LDCs and many commodity dependent countries have been very meagre and very little has gone into agriculture.

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[11] Potential and constraints of the agricultural commodities in the United Republic of Tanzania. Paper prepared for UNCTAD/Common Fund for Commodities Workshop, Geneva, 22-23 March 2001.

48. Concerning domestic savings, the most important problem is the low level of income. Forty-four per cent of the population in LDCs have a per capita income of under $1 a day, and 75 per cent have a per capita income of less than $2 a day. Consequently, savings are very low. In LDCs, domestic resources available for finance represent a much smaller share of the gross national product (GNP) than in other developing countries. It varied between 15 per cent (in the case of Asian and African countries) and 20 per cent (for island countries) during the 1980s and 1990s.

49. In addition to foreign sources of finance, the mobilization of local funds through actions specific to the commodity sector is a crucial factor. While banks consider agriculture and agro-industries too risky, and farmers often lack the conventional collateral required by lenders and are faced with social constraints associated with land tenure, lending risks would be limited, financing conditions improved and available funds increased through the development and use of warehouse receipt systems based on regulated and guaranteed commodity storage. Management of price risks through market-based instruments would also reduce the risks of lending to the commodity sector and improve the availability of finance.

D. The case of countries dependent on mining

50. The central problem for these countries is how to channel the income from mineral exports into the building of human and physical capital.[12] A large part of this income usually accrues to the Government in the form of taxes, partly as a compensation for the exploitation of non-renewable resources, and partly because the limited employment and the high import content in material inputs leave few other means for a developing country to share in the wealth generated by mineral exploitation. For this reason, the role of Governments in the diversification process has to be more proactive than in countries that export mainly agricultural commodities. This also means that governance issues should receive considerably more attention, since failings in this respect can easily lead to considerable losses in terms of development achievements.

51. For many developing countries, promotion of mineral investment and export is an attractive way to escape from the "poverty trap" resulting from low savings and severely limited resources for investment in diversification. The availability of additional government income can make possible the investments in infrastructure and human capital that are necessary to increase productivity and diversify into the production of "new" commodities. The "fiscal linkage" is not the only aspect of mineral commodity production and export that opens opportunities for diversification or should receive the attention of Governments. The acquisition of technical and business skills through mineral production can be highly significant and most of the skills can easily be applied in other sectors.

[12] The problems faced by countries dependent on fishery and forestry resources are similar to those dependent on mineral resources, but are compounded by the necessity to ensure the sustainable use of these renewable resources.

52. Diversification into more processed products through vertical integration may in some cases be an option for countries with large mineral resources. in the case of fuel-producing countries, expansion into downstream processing has proved possible in many cases. However, for producers of non-fuel minerals, such diversification often requires access to low-cost energy at the stage of processing ore into unwrought metal. Processing unwrought metal into semi-fabricated metal products introduces some of the same requirements as for producers of agricultural commodities, for instance good logistics, access to up-to-date market intelligence, quality control, access to credit and the skills necessary to apply risk management techniques, given the usually slim margins in this industry.

E. Some indicative questions for the experts

53. The following are some of the questions that arise from the preceding discussion and that the experts may wish to address:

1. What are the most important trade barriers affecting diversification and industrialization in commodity dependent developing countries (CDDCs)? What should be the priority areas of negotiation for these countries, particularly single commodity exporters, in the post-Doha framework? Can the interests of different groups of CDDCs be reconciled, for instance in relation to the Development Box? What would be the most efficient forms of special and differential treatment for facilitating diversification and industrialization?

2. Would a significant liberalization lead to more fundamental gains than preferential tariff margins? Should the emphasis in negotiations be on reduction of agricultural protectionism for the benefit of all exporters or on special and differential treatment?

3. What are the most important areas of technical assistance that the experts would recommend and what is the best mode of delivery and dissemination? What should be the place of technical assistance requirements in the WTO negotiations?

4. Are sanitary and phytosanitary (SPS) and technical barriers to trade (TBT) requirements for processed products easier to meet than those for fresh ones? How significant are the quality and other requirements set by the importing firms? Do standards set by different firms vary much, leading to difficulties with compliance and switching between buyers?

5. What are the most beneficial aspects of links with foreign companies? How can these be promoted and strengthened?

6. Is it possible to make a general statement about the most advantageous point of entry into international commodity chains, taking into account the labour intensity of different stages and the oligopolistic nature of markets?

7. What is the impact of the increasing influence of supermarkets in international food trade? How important would it be if CDDCs were financially assisted in obtaining premium shelf space in supermarkets?

8. What are the most cost-effective means for "differentiation"? Would "regional branding programmes" be feasible and meaningful?

9. What are the most important gaps in research and development, and what is the best mode of delivery and dissemination?

10. What are the most important areas of government support in different types of CDDCs? How should such support be organized so that it reaches those in greatest need of it?

11. Would local and regional markets be a meaningful stepping stone for diversification and entering international markets?

12. What demands can be made of large transnational companies that would assist in diversification and industrialization?

13. What are the best ways of ensuring that natural resource rents and profits made from exporting are used for further development and industrialization?

14. Are there practical ways to alleviate difficulties caused by the cost and availability of transport?

15. What are the best means of improving the availability of finance for the agriculture sector and for diversification projects? What changes are needed in domestic legislation?

16. What can be expected from international commodity organizations and the Common Fund for Commodities as support for diversification? How can they be strengthened in this respect?

17. Given its mandate and expertise, what would be an effective and efficient role for UNCTAD in assisting diversification and industrialization in CDDCs?