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Pathways to economic diversification in commodity-dependent developing countries

Note by the UNCTAD secretariat

Summary

This note contains a review of issues related to diversification in commodity-dependent developing countries and net food-importing developing countries. The urgent need for diversification is highlighted in the context of recent crises, including the pandemic, the war in Ukraine and the climate crisis. Commodity dependence is associated with a range of negative impacts and heightened risks; diversification can not only reduce volatility emanating from international commodity markets but also act as a driver of growth and development. Successful examples of diversification show that strong political leadership is required to escape the "commodity dependence trap". In this regard, a range of broad-based enabling conditions and targeted policy measures are discussed in the note. In addition, strategies need to be tailored to country-specific conditions; and regional integration and international cooperation can help remove obstacles to diversification and value upgrading. Commodity-dependent developing countries benefiting from a recent period of high commodity prices could use the opportunity to promote diversification and value upgrading and thereby reduce commodity dependence in future. Resilience in net food-importing developing countries could be strengthened through the diversification of food import sources, including through regional trade and the promotion of the productivity and diversity of domestic food production and by building food stocks to absorb short-term shocks.

Introduction

1. The Accra Accord, in paragraph 208, gave a mandate to the Trade and Development Board of UNCTAD to establish a multi-year expert meeting on commodities. The mandate was reaffirmed in paragraph 17 of the Doha Mandate, which extended it to 2016, and in paragraph 100 (s) of the Nairobi Maafikiano, which extended it to 2020. The mandate has been further extended in line with paragraphs 123 and 127 (m) and (kk) of the Bridgetown Covenant; the latter state that UNCTAD should “pay special attention to the challenges of the commodity-dependent developing countries, as well as net food-importing developing countries” and “continue to address the challenges faced by developing countries in diversifying their economies, and assist them in formulating development policies conducive to achieving sustainable and inclusive development”.[1]

2. This note, in accordance with the decision of the Trade and Development Board at its seventy-first executive session on formal approval of the topics of the multi-year expert meetings and the single-year expert meeting,[2] provides a discussion of pathways to economic diversification in commodity-dependent developing countries and net food-importing developing countries. Commodity dependence continues to be widespread and presents a source of external risk and volatility in commodity-dependent developing countries and, as recent research by UNCTAD has shown, commodity dependence can be a trap;[3] in this note, pathways are identified out of this trap and towards a more diversified production and export structure in these countries. In addition, challenges in net food-importing developing countries are highlighted, with a particular focus on recent crises that have had major impacts on international food markets. Diversification and value addition, as stated in the note, are broad developmental challenges that require a holistic policy framework that includes broad-based enabling conditions, as well as targeted measures. Finally, several entry points are identified in the promotion of diversification in commodity-dependent developing countries and net food-importing developing countries.

I. State of commodity dependence and associated challenges

A. Dependence on commodity exports

3. An economy is defined as commodity dependent when it derives 60 per cent or more of its merchandise export revenues from primary commodities such as food, agricultural raw materials, base metals and crude oil. According to this threshold, in the period 2018–2020, 101 of the 195 UNCTAD member States were commodity dependent, based on data from the UNCTADstat database,[4] and an additional 14 countries had a share of commodities in exports in the range of 50–60 per cent. Commodity dependence is more prevalent at earlier stages of development. In the same period, 16 per cent (6 of 38) of member States of the Organisation for Economic Co-operation and Development were commodity dependent and the share among non-member States was 62 per cent (95 of 153). In addition, 81 per cent (26 of 32) of landlocked developing countries, 61 per cent (23 of 38) of small island developing States that are United Nations Member States and 78 per cent (36 of 46) of the least developed countries were commodity dependent (figure 1). A complicating factor in many commodity-dependent developing countries is dependence on export revenue from a narrow range of commodities or even a single commodity. For example, based on data from the UNCTADstat database, in 2020, copper,

[1] TD/541/Add.2.

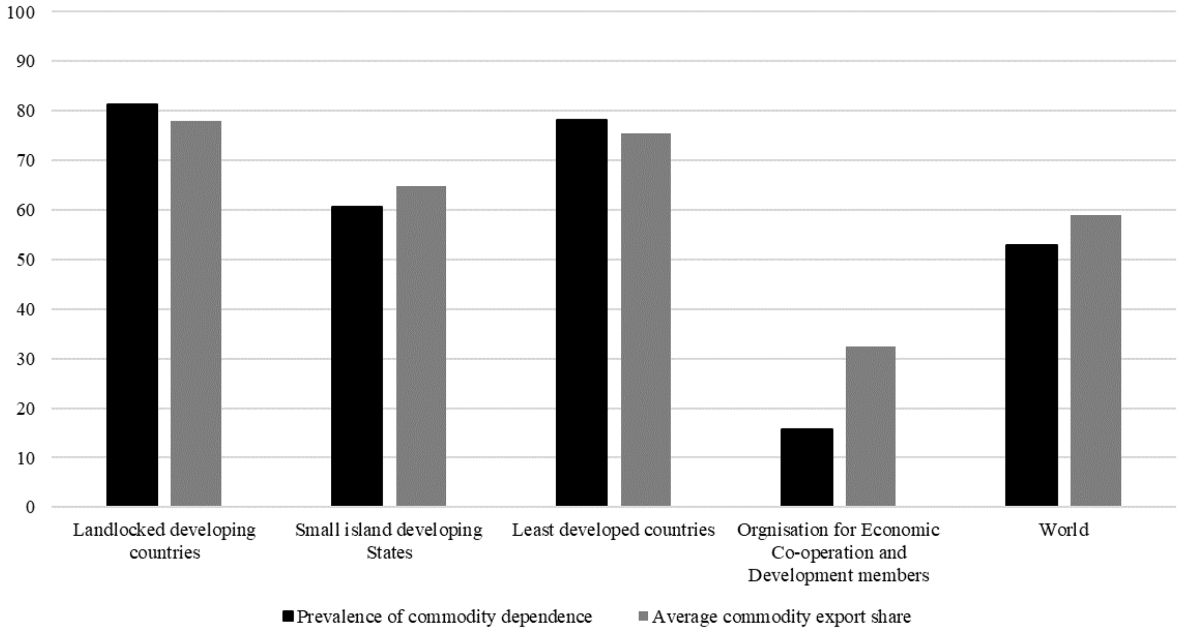
[2] TD/B/EX(71)/3.

[3] UNCTAD, 2021a, *Commodities and Development Report 2021: Escaping from the Commodity Dependence Trap through Technology and Innovation* (United Nations publication, Sales No. E.21.II.D.14, Geneva).

[4] Data are not available for Monaco, San Marino and the Holy See; trade data for Liechtenstein are reported together with data for Switzerland. Country groupings in paragraphs 2 to 4 are in line with those in the UNCTADstat database.

crude oil and gold accounted for 74, 79 and 81 per cent of the total merchandise export revenue of Zambia, Iraq and Suriname, respectively.

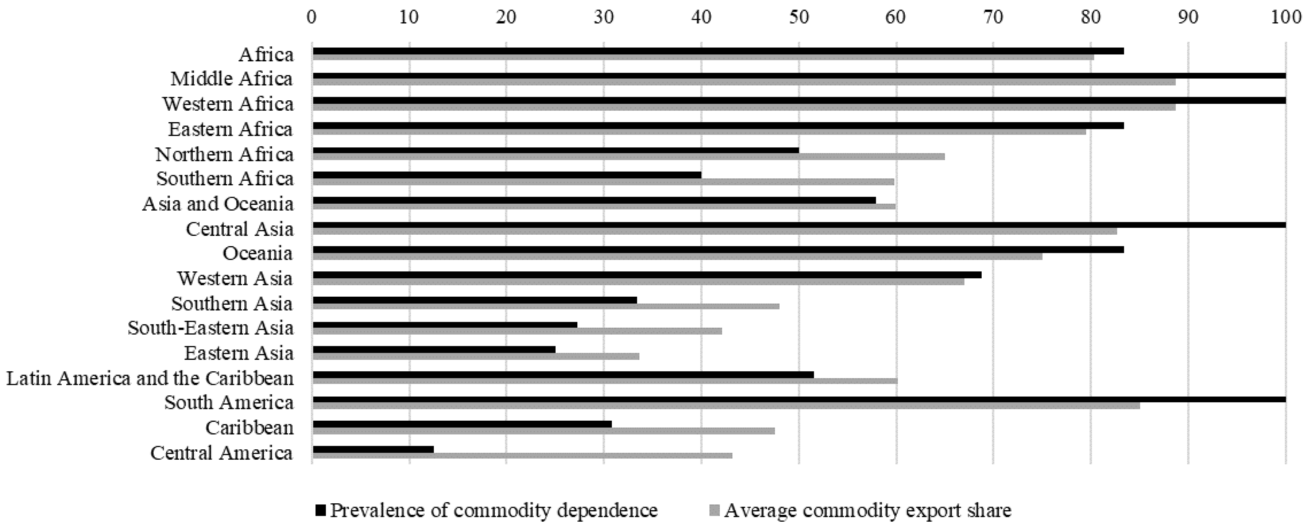
Figure 1
Commodity dependence by country grouping, 2018–2020
(Percentage)



Source: UNCTAD secretariat calculations, based on data from the UNCTADstat database.

4. Commodity dependence is prevalent across developing countries, yet there are regional and subregional concentrations (figure 2). In the period 2018–2020, in Africa, 83 per cent of countries (45 of 54) were commodity dependent, with all countries in Middle and Western Africa in this category; and in Africa, the average share of commodities in total merchandise exports was 80 per cent. In the same period, in Asia and Oceania, 58 per cent of countries (33 of 57) were commodity dependent, with all countries in Central Asia in this category; and, in Asia and Oceania, the average share of commodities in total merchandise exports was 60 per cent. In the same period, in Latin America and the Caribbean, 52 per cent of countries (17 of 33) were commodity dependent, with all countries in South America in this category; and, in Latin America and the Caribbean, the average share of commodities in total merchandise exports was 60 per cent.

Figure 2
Commodity dependence by region, 2018–2020
(Percentage)



Source: UNCTAD secretariat calculations, based on data from the UNCTADstat database.
Notes: In the period 2018–2020, the median shares of commodities in total merchandise exports in Africa, Asia and Oceania and Latin America and the Caribbean were 87, 71 and 60 per cent, respectively. Country groupings are in line with those in the UNCTADstat database.

5. Commodity dependence has been shown to be associated with a wide range of negative social and economic outcomes, ranging from lower levels of human and social development to slow productivity growth, income volatility, macroeconomic instability, political instability and exchange rate overvaluation.[5] In addition to the challenges associated with commodity dependence itself, commodity-dependent developing countries also face significant and often disproportionate impacts from crises that affect the global economy, such as the pandemic, the war in Ukraine and climate change. Therefore, building resilient economies in these countries is crucial to achieving the Sustainable Development Goals.

6. The pandemic led to a dramatic deceleration of global economic activity in 2020, as well as a sharp contraction in commodity markets. The UNCTAD commodity price index declined by 35.7 per cent in January–April 2020, at the start of the pandemic. The economic downturn in 2020 caused a reversal in development achievements worldwide, including in many commodity-dependent developing countries. For example, it is estimated that the pandemic pushed an additional 97 million people into poverty in 2020.[6] The pandemic also slowed or reversed progress with regard to other targets under the Goals, such as on education and food security, and therefore threatens to weigh on future growth and development prospects. For example, estimates suggest that in low-income and middle-income countries, the pandemic could serve to drive up learning poverty, that is, the share of 10-year-olds who cannot read a basic text, from 53 per cent prior to the pandemic to 70 per cent.[7] In addition, globally, the prevalence of undernourishment increased from 8.4 per cent in 2019 to 9.9 per cent in 2020, with Africa, which is heavily commodity dependent and the region with the greatest prevalence of undernourishment, experiencing the steepest increase.[8] The pandemic affected the most vulnerable groups disproportionally, which has further increased inequality within and

[5] See UNCTAD, 2021a.
[6] See https://blogs.worldbank.org/opendata/updated-estimates-impact-covid-19-global-poverty-turning-corner-pandemic-2021.
Note: All websites referred to in this note were accessed in July 2022.
[7] See https://www.worldbank.org/en/news/press-release/2021/10/29/world-bank-pandemic-threatens-to-drive-unprecedented-number-of-children-into-learning-poverty.
[8] See https://www.fao.org/3/cb4474en/online/cb4474en.html#chapter-2_1.

between countries. For example, the pandemic reduced an estimated 4.2 per cent of women's employment in 2020, compared with 3 per cent of men's employment; and the income gap between countries was also expected to increase due to the pandemic.[9] When faced with income losses, poor households, such as those of many smallholders in commodity-dependent developing countries, tend to use coping strategies that reduce future income prospects and, thereby, the likelihood of reducing poverty.[10] All of this suggests that inequality should be a key focus of domestic and international efforts in recovering from the pandemic.

7. Climate change disproportionally affects commodity-dependent developing countries compared with their contribution to global warming. For example, in 2019, the 25 most vulnerable countries were all commodity-dependent developing countries.[11] In addition to direct impacts from climate change on commodity value chains, a rapid decarbonization of the global economy, required to reach the objectives of the Paris Agreement under the United Nations Framework Convention on Climate Change, poses significant risks for countries that depend on fossil fuel exports, the majority of which are commodity-dependent developing countries. In this context, the costs associated with stranded assets and resources are likely to have a disproportionate effect on the commodity-dependent developing countries dependent on such resources to fund the achievement of the Goals.

B. Dependence on imports of food and other basic commodities

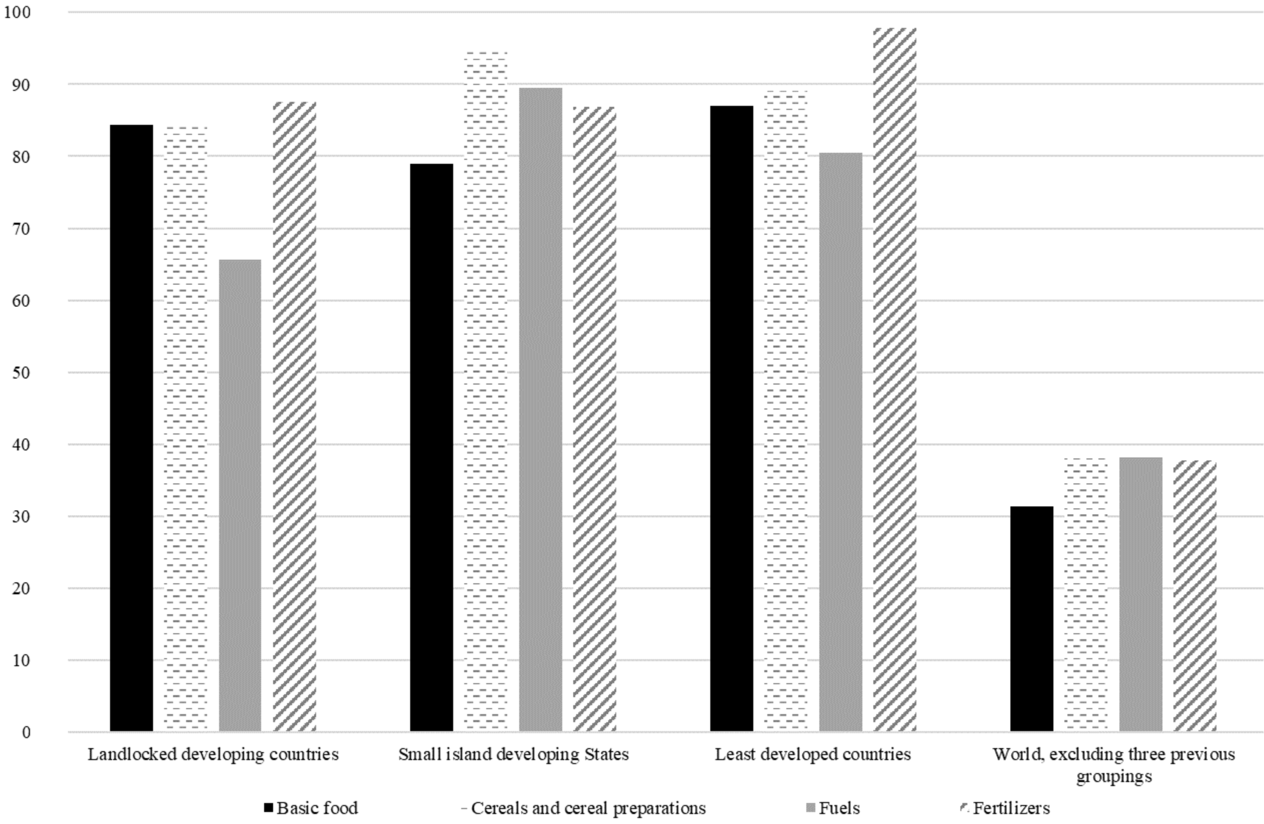
8. Many countries depend on imports of basic commodities such as food, fuel and fertilizers. However, the share of net importers (countries in which imports are greater than exports, in value terms) of these key commodity groups is greatest among landlocked developing countries, small island developing States and the least developed countries (figure 3). For example, in the period 2018–2020, the share of net importers of basic food among landlocked developing countries was 84 per cent (27 of 32), significantly higher than the share of 31 per cent among countries not in these three groupings. In the same period, 95 per cent (36 of 38) of small island developing States were net importers of cereals and cereal preparations, highlighting a near total dependence on international trade for food security. Similarly, 98 per cent (45 of 46) of the least developed countries were net importers of fertilizers, suggesting a close link between agricultural productivity in the poorest countries and the availability and affordability of this key input in global markets. In addition, the share of net importers of fuel such as crude oil, natural gas and coal is substantially higher among these three groupings than in other countries.

[9] See https://www.ilo.org/gender/Informationresources/Publications/WCMS_814499/lang--en/index.htm.

[10] World Bank, 2013, *World Development Report 2014: Risk and Opportunity – Managing Risk for Development*, Washington, D.C.

[11] See https://gain.nd.edu/our-work/country-index/rankings/.

Figure 3
Share of net importers of basic commodities by country grouping, 2018–2020
(Percentage)



Source: UNCTAD secretariat calculations, based on data from the UNCTADstat database.
Notes: Basic food corresponds to sections 0 and 4 (excluding division 07 (coffee, tea, cocoa, spices and manufactures thereof)) and division 22 under the Standard International Trade Classification; cereals and cereal preparations, to division 04; fuels, to section 3; and fertilizers, to group 562 under division 56. The group of small island developing States includes United Nations Member States only.

9. The pandemic and the war in Ukraine created significant challenges for net food-importing developing countries and developing countries that depend on imports of other basic commodities such as fuel and fertilizers. Challenges include price volatility, sudden price hikes and supply chain disruptions, including with regard to crucial food staples. For example, the Russian Federation and Ukraine are key suppliers of wheat to global markets, jointly accounting for 27 per cent of global wheat exports in 2020.[12] Commercial vessels prevented from leaving Black Sea ports due to the war in Ukraine led to a significant reduction in the supply of wheat exports from this region. As a consequence, countries that depend to a large extent on wheat imports from this region, including many countries in Africa and the least developed countries, faced not only increasing import bills but also uncertainty about the physical availability of wheat. In the context of global supply uncertainties, some countries implemented export bans on wheat and other grains, which further exacerbated the situation in global markets. Such crises highlight the importance of diversifying supply sources of basic commodities as a means of reducing the significant risks associated with overreliance on a narrow range of import sources.

[12] UNCTAD, 2022a, The impact on trade and development of the war in Ukraine: UNCTAD rapid assessment, available at https://unctad.org/webflyer/impact-trade-and-development-war-ukraine.

II. Pathways to diversification

A. Diversification of production and exports

10. Diversification can be defined as a reduction in the concentration or an increase in the variety of production and exports. In this sense, diversification in commodity-dependent developing countries goes hand-in-hand with a process of structural transformation, that is, a reallocation of production factors across sectors, industries and firms to produce a greater and/or more valuable set of goods and services. This reallocation process can take place at many levels, such as across broadly defined sectors of the economy, from agriculture to manufacturing or services, and also within individual commodity sectors. Diversification is defined as horizontal if it primarily broadens the production and export base and as vertical if it involves an increase in variety that occurs along the value chain of an existing sector. The latter can take place at different levels of complexity and sophistication. An example of a relatively small-scale vertical diversification process is a shift from the export of raw agrifood commodities, such as raw cashew nuts, to the domestic processing and export of value added food products, such as cashew kernels. An example of a larger-scale vertical diversification process that requires significant resources and investments is a shift, in an oil-exporting country, of part of crude oil production towards the manufacturing of plastic and chemical products. An additional dimension of diversification in commodity-dependent developing countries is a reduction in the concentration of export markets.

11. A shift towards a more diversified output and export structure can bring a range of benefits in commodity-dependent developing countries. Primarily, less concentration in commodity sectors means lower levels of vulnerability to shocks and volatility emanating from international commodity markets that are governed by forces beyond the control of individual countries. The volatility of export earnings translates directly into volatility in public revenue in commodity-dependent developing countries that often depend to a significant extent on taxes and levies on commodity production and trade. This, in turn, can compromise the continuity of public spending in key areas of sustainable development and thereby threaten the achievement of the Sustainable Development Goals. For example, when crude oil prices fell in 2014–2015, many oil-exporting economies (Algeria, Angola, Iraq, Nigeria, Saudi Arabia and the Bolivarian Republic of Venezuela) faced budget crises and were forced to cut spending and government investment. In the same period, the currencies of many commodity-dependent developing countries experienced steep depreciations as a consequence of decreasing commodity prices, including the kwanza, Angola; the naira, Nigeria; and the kwacha, Zambia. In addition, in the absence of sound fiscal policy frameworks, fluctuations in government revenue may result in procyclical spending patterns that undermine fiscal sustainability and exacerbate output volatility. In this context, it is important to note that a reduction in commodity dependence needs to be supported by the diversification of government revenue sources. This means that Governments need to broaden tax bases and increase revenue from non-commodity sources. Doing so would not only allow for the maintenance of public spending levels during the diversification process but also stabilize total revenue flows over time, as non-resource revenue tends to be less volatile than commodity revenue.

12. Diversification is not only an insurance mechanism, with which commodity-dependent developing countries can reduce exposure to volatility in international commodity markets, but it can also act as a driver of economic growth and development. For example, there is significant potential for both productivity-enhancing structural change and intrasectoral productivity growth in commodity-dependent developing countries.[13] Diversification can drive productivity gains, create employment opportunities and lead to increasing real incomes. Empirical evidence shows the positive effect of export diversification on per capita income growth in developing countries.[14] In addition, research

[13] UNCTAD, 2021a.

[14] H Hesse, 2008, Export diversification and economic growth, Commission on Growth and Development Working Paper No. 21, World Bank; D Lederman and WF Maloney, 2007, *Natural Resources: Neither Curse Nor Destiny*, World Bank, Washington, D.C.

by UNCTAD on the commodity dependence trap has shown that strong policies are needed to escape from this trap.[15] Commodity-dependent developing countries face particular challenges, to which diversification strategies must be tailored. However, experience shows that most countries that have successfully diversified their economies have relied on a combination of horizontal policies that generally improve the basis for economic activity and measures directly targeted at promoting priority sectors. Among the fundamental factors that need to be in place is a market environment conducive to investment, business activity and international trade. This includes stable macroeconomic conditions, a regulatory framework that facilitates private sector initiative and a strong human capital base.

13. Market access conditions are also a key factor in successful diversification. In this context, tariff escalation is an important challenge in commodity-dependent developing countries. Tariff escalation occurs when import tariffs are higher for processed goods than for the primary commodities that are the inputs of the production processes of these goods. Tariff escalation is more pervasive in manufacturing than in agriculture and is a feature of the trade regimes of both developed and developing countries.[16] Tariff escalation in manufacturing could be a contributing factor to the lack of industrialization in commodity-dependent developing countries, and poses an obstacle to export diversification. Tariff peaks that are often concentrated in agricultural goods such as food products can also limit scope for export diversification in these countries. In this regard, it is important that trade liberalization under the framework of the World Trade Organization continue to address, through trade negotiations, the issue of tariff escalation and tariff peaks faced in many commodity-dependent developing countries. In addition, these countries should include in diversification strategies a detailed analysis of the tariff structure they face in export markets, including opportunities arising from existing trade preferences.

14. In addition to tariffs, non-tariff measures may limit market access for commodity-dependent developing countries. Such measures comprise all policies and regulations, except trade tariffs, that can have an impact on trade quantities or prices. For example, sanitary and phytosanitary measures and technical barriers to trade are widespread with regard to agrifood products, a key sector in many commodity-dependent developing countries. Such measures include quality standards, food safety regulations and labelling and traceability requirements. Compliance costs and capacity constraints often act as barriers to commodity-dependent developing countries aiming to broaden the range and increase the value added of agrifood exports to key consumer markets. To address such challenges, these countries, together with development partners, need to build national capacity to reduce trade costs caused by non-tariff measures and thereby improve market access for a broader set of value added goods. In this regard, the strengthening of domestic quality infrastructure can also help limit the impact of non-tariff measures by ensuring the quality and safety of products and thereby facilitating market access. In addition, commodity-dependent developing countries would benefit from a rationalization of unnecessary non-tariff measures applied by trade partners that hinder diversification and value upgrading; and increased transparency regarding non-tariff measures, in particular by strengthening access by private sector firms in commodity-dependent developing countries to information on regulations and compliance requirements, can help reduce compliance costs for exporters.

15. Diversification and value upgrading also depend on the availability of inputs for new and higher value added products. Where such intermediary goods or services are not available in the domestic market, the trade policy regime should facilitate access by local firms to such goods or services at competitive costs. In addition, a lack of competition in domestic input markets can compromise the competitiveness of exporters in international markets, and needs to be addressed through an appropriate competition policy response. For example, there is evidence suggesting that, in Malawi and the United Republic of Tanzania, a lack of competition led to markups of the price of fertilizers, an essential input

[15] UNCTAD, 2021a.

[16] UNCTAD, 2022b, *Key Statistics and Trends in Trade Policy 2021* (Geneva).

in agriculture.[17] Key services such as transportation and telecommunications can also be subject to anticompetitive behaviour, resulting in lower quality levels and higher prices and thereby hindering the competitiveness of firms that depend on these services. A strong competition authority that effectively prosecutes collusion and other anticompetitive behaviour can help maintain efficient input markets and thereby strengthen the competitiveness of exporting firms in commodity-dependent developing countries.

16. Another key factor with regard to trade costs and competitiveness is the availability and quality of physical infrastructure, including transport infrastructure such as roads, ports and airports. All commodity-dependent developing countries could benefit from improvements in infrastructure, yet this is a particularly important policy area in landlocked commodity-dependent developing countries that rely on the infrastructure and policies of neighbouring countries, putting them at a geographical disadvantage. Among this group of countries, regional integration can help ensure trade connectivity with global markets through transit countries. Implementation of the African Continental Free Trade Area could play an important role in this regard.

17. The establishment of special economic zones is an example of a targeted measure to promote diversification and industrial upgrading. Special economic zones have been established worldwide, with nearly 5,400 such zones across 147 economies in 2019.[18] Overall, performance has varied widely across regions, countries and individual zones. Experience shows that in order for such zones to be successful, it is crucial for their design, policy framework and strategic focus to be tailored to country-specific conditions and international economic trends.[19] For example, special economic zones need to have access to quality infrastructure services such as electricity and telecommunications and to be connected to transport routes. Labour supply conditions also need to be considered in their design. Policy and institutional coordination are also crucial aspects, as well as effective partnerships between Governments, international institutions and firms. Measures that strengthen the links between special economic zones and local firms can improve the impact of such zones and help spread knowledge and innovation beyond their borders. Such measures could include industry-specific capacity-building and training programmes to strengthen the productivity and capabilities of local private sector firms; networking events bringing together firms in special economic zones and local businesses; and the sharing of information on local suppliers with foreign firms operating in special economic zones. For example, in Ethiopia, there has been some success in linking industrial parks focused on the garment industry with local suppliers.[20]

18. Access to energy is a key consideration with regard to the diversification of production and exports in commodity-dependent developing countries. Energy is a key input into nearly all products and services and the availability and affordability of energy is therefore an important factor in determining production costs and thereby the competitiveness of exports from a country to international markets. An efficient and reliable energy sector is therefore a precondition for diversification and value upgrading. However, access to energy remains a key challenge in many commodity-dependent developing countries, in particular in Africa. For example, in 2020, the 20 countries with the lowest share of the population with access to electricity were all commodity-dependent developing countries in sub-Saharan Africa (see table). In the period 2018–2020, the average share of commodities in exports of this group of countries was 89.2 per cent, which indicates deeply entrenched commodity dependence. Exporters of crude oil, natural gas and coal, such as Angola, Chad, Mozambique and South Sudan, are in this group of 20 countries, illustrating that an abundance of energy resources does not necessarily translate into universal energy access. Commodity-dependent developing countries in which energy access remains a challenge, together with development partners, should therefore focus on deploying energy resources towards improving energy access, with the

[17] See https://openknowledge.worldbank.org/handle/10986/27527.

[18] UNCTAD, 2019, *World Investment Report 2019: Special Economic Zones* (United Nations publication, Sales No. E.19.II.D.12, Geneva).

[19] See https://unctad.org/webflyer/handbook-special-economic-zones-africa.

[20] L Whitfield,C Staritz and M Morris, 2020, Global value chains, industrial policy and economic upgrading in Ethiopia’s apparel sector, *Development and Change*, 51(4):1018–1043.

aim of achieving Goal 7, on ensuring access to affordable, reliable, sustainable and modern energy for all, and as a way of creating the energy infrastructure needed to promote diversification and value upgrading.

Countries with the lowest levels of access to electricity
(Percentage)

	Share of population with access to electricity, 2020	*Share of commodities in total merchandise exports, 2018–2020*
South Sudan	7.2	99.9
Chad	11.1	98.4
Burundi	11.7	93.1
Malawi	14.9	92.0
Central African Republic	15.5	79.9
Burkina Faso	19.0	97.2
Democratic Republic of the Congo	19.1	82.8
Niger	19.3	87.0
Sierra Leone	26.2	85.5
Liberia	27.5	71.7
Mozambique	30.6	95.6
Guinea-Bissau	33.3	99.8
Madagascar	33.7	72.9
United Republic of Tanzania	39.9	78.3
Benin	41.4	91.1
Uganda	42.1	85.0
Zambia	44.5	89.8
Guinea	44.7	95.7
Rwanda	46.6	91.7
Angola	46.9	96.4

Source: UNCTAD secretariat calculations, based on data from the UNCTADstat database and the World Development Indicators database of the World Bank.

19. In commodity-dependent developing countries that depend on the export of fossil fuels, diversification is also a means of anticipating potentially shrinking markets for crude oil, natural gas and coal, and avoiding a situation in which their natural resources and associated assets are stranded. For example, one estimate suggests that, to meet the target in the Paris Agreement of not exceeding a global rise of 2°C above pre-industrial temperatures, globally, one third of oil reserves, half of natural gas reserves and over 80 per cent of current coal reserves should remain unused until 2050.[21] In this regard, the current relatively high price of fossil fuels may be seen as an opportunity to use the rents derived from these natural resources to diversify production and exports, thereby reducing commodity dependence in future. Such structural transformation could be supported by green industrial policies that promote transformation towards production and export structures aligned with the objectives of a green energy transition and the need to address climate change-related challenges.

20. Technology is another important component of diversification. Research by UNCTAD shows that the likelihood of commodity dependence is strongly associated with low levels of technology.[22] Innovation and technological development should therefore be a key pillar of strategies for economic diversification in commodity-dependent developing

[21] C McGlade and P Ekins, 2015, The geographical distribution of fossil fuels unused when limiting global warming to 2°C, *Nature*, 517:187–190.
[22] UNCTAD, 2021a.

countries. Diversifying into more dynamic sectors might require these countries to take "large jumps" in innovation that cannot be made without State intervention. Mechanisms should be put in place to create an ecosystem for technology transfer from abroad, as well as related learning. Therefore, it is essential that international public and private partners of commodity-dependent developing countries support technology transfer and strengthen efforts towards building the human, physical and institutional capabilities required with regard to new technologies.

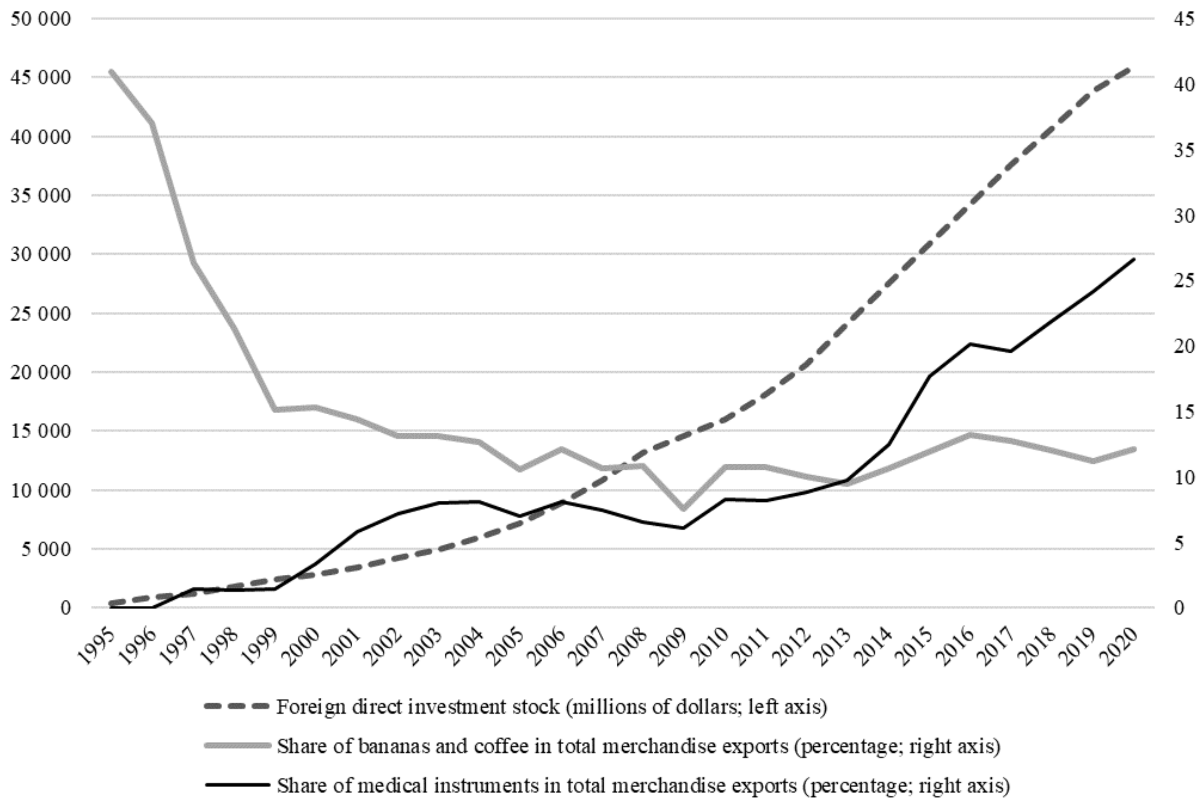
21. Innovation and digital technologies can also help commodity-dependent developing countries raise the productivity levels of commodity sectors and move up value chains. Many commodity value chains are not transparent and are long, fragmented and concentrated in the hands of a few large players. For example, research by UNCTAD shows that over 50 per cent of global cashew nut production takes place in Africa, yet over 85 per cent of shelling industries are located in Asia and over 60 per cent of cashew kernel exports are destined to the United States of America and the European Union.[23] Similarly, in 2020, based on data from the Comtrade database, the United States and the European Union (28 countries) jointly accounted for 63 per cent of cocoa bean imports. The coffee market is also highly concentrated. For example, in 2016, five international trading companies handled over 40 per cent of the global coffee trade and two major roasters controlled about one quarter of the global market.[24] Innovation and technology can help to not only increase the productivity of commodity processing in commodity-dependent developing countries but also reduce trade costs and improve transparency, which is a key factor in helping commodity exporters gain direct access to consumer markets.

22. Most countries that have successfully diversified their economies have relied on a combination of horizontal policies and measures targeted at individual sectors. Costa Rica provides a good example in this regard. Until the early 1990s, bananas and coffee were the main export goods, after which Costa Rica began to actively attract foreign direct investment, which played a major role in economic transformation (figure 4). In parallel with the build-up of foreign direct investment stock, the share of bananas and coffee in total merchandise exports declined from 41 per cent in 1995 to 11 per cent in 2005. The build-up of high value added sectors included the production of medical instruments, a sector that, in 1995, was insignificant in 1995 and, in 2020, accounted for 27 per cent of total exports. In this context, market access was crucial, since the country attracted mainly efficiency-seeking foreign direct investment, with a focus on exporting goods produced in Costa Rica. Industrial policy, investment promotion and trade policy therefore worked together, to enable structural transformation. Costa Rica also invested in the development of the tourism sector, which, directly and indirectly, accounted for an estimated 13.2 per cent of gross domestic product and 12.9 per cent of total employment, respectively, in 2019.

[23] UNCTAD, 2021b, *Commodities at a Glance: Special Issue on Cashew Nuts* (United Nations publication, Geneva).

[24] UNCTAD, 2018, *Commodities at a Glance: Special Issue on Coffee in East Africa* (United Nations publication, Geneva).

Figure 4
Costa Rica: Foreign direct investment stock and share of certain sectors in exports



Source: UNCTAD secretariat calculations, based on data from the UNCTADstat database and the Comtrade database.

Note: Bananas correspond to Harmonized System code 0803; coffee, to code 0901; and medical instruments, to code 9018.

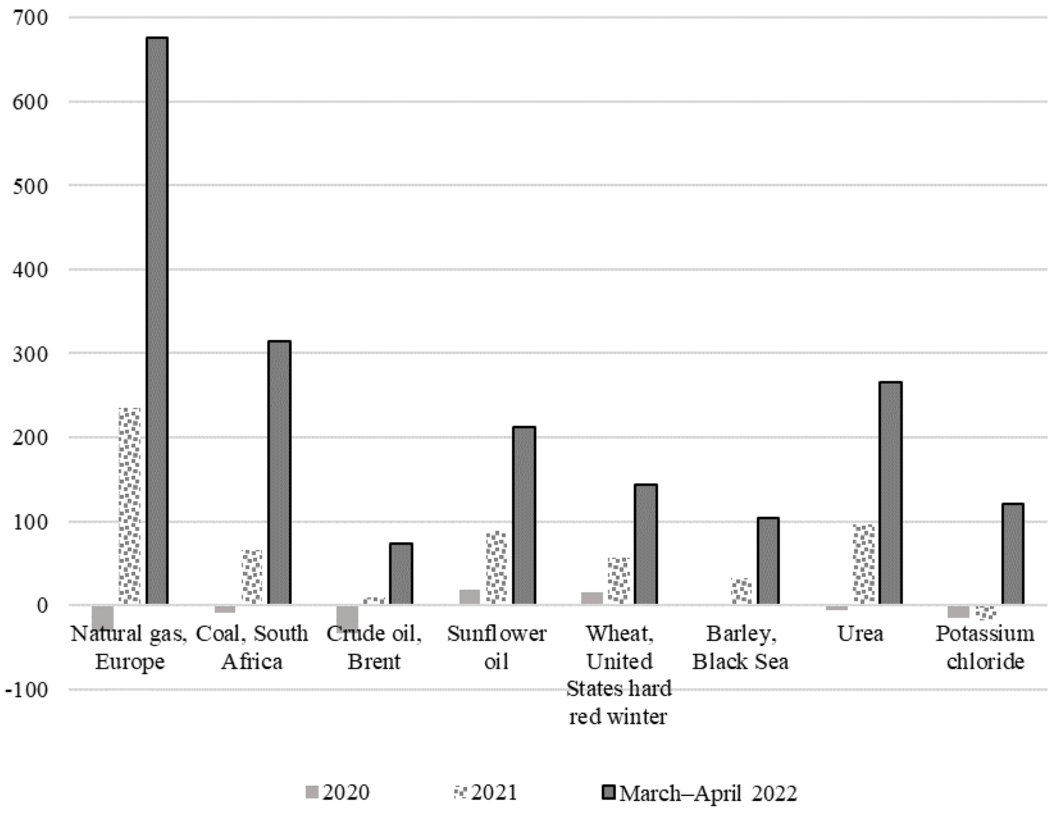
23. There are several additional examples of countries that have successfully diversified production and exports or climbed up the value chain of commodity sectors. For example, Botswana has established a diamond processing industry, which includes the cutting and polishing of raw diamonds, and developed a growing tourism industry; Chile has developed a diversified non-minerals export sector in parallel with growing copper production and exports; and Indonesia has promoted domestic beneficiation in the minerals sector in order to become a leading exporter of stainless steel. In Indonesia, based on data from the Comtrade database, the export value of the iron and steel sector (Harmonized System code 72) increased by more than tenfold within five years, from $1.8 billion in 2016 to $20.9 billion in 2021. In addition, in Malaysia, the economy has been diversified, from a highly concentrated commodity-based production and export structure; in 2020, manufacturing accounted for 73 per cent of merchandise export value, with parts and components for electrical and electronic goods accounting for 34 per cent of total exports. Diversification strategies have been formulated in other commodity-dependent developing countries, and these countries are at various stages on the path towards diversification and value upgrading. For example, economic diversification is included in key forward-looking policy documents of gas and oil-dependent economies of the Gulf Cooperation Council, such as in Vision 2030, Bahrain; Vision 2035, Kuwait; Vision 2040, Oman; National Vision 2030, Qatar; Vision 2030, Saudi Arabia; and Economic Vision 2030, Abu Dhabi, United Arab Emirates.

B. Diversification in net food-importing developing countries

24. Diversification can also be a risk mitigation tool in net-food importing developing countries. Similar to commodity export dependence, an overreliance on imports of food and

other basic commodities can be a source of risk and volatility. A concentration of supply sources of such imports in a single country or region compounds the associated risk and can have significant consequences in case of a supply shortfall or market disturbance along supply chains. Certain effects of the war in Ukraine serve as an example of the risks faced by net importers of basic commodities, in particular those reliant on a narrow range of supply sources, as shown by a rise after the start of the war in the prices of key commodities exported by the Russian Federation and Ukraine (figure 5). This rise added to a broad-based trend of rising commodity prices that started in mid-2020 after the initial shock of the pandemic. Due to the war, the differences in prices, compared with pre-pandemic levels in 2019, of basic food items, as well as energy commodities and fertilizers, were in the high double digits or even triple digits. For example, the average prices of wheat and sunflower oil in March–April 2022 were, respectively, 143 per cent and 213 per cent higher than the respective averages in 2019.[25]

Figure 5
Price changes in selected commodities compared with prices in 2019
(Percentage)



Source: UNCTAD secretariat calculations, based on data from the Food and Agriculture Organization of the United Nations and the World Bank.

[25] See https://thedocs.worldbank.org/en/doc/5d903e848db1d1b83e0ec8f744e55570-0350012021/related/CMO-Pink-Sheet-May-2022.pdf.

25. A rise in prices may cause a range of negative impacts on sustainable development in net food-importing developing countries. In particular, sudden rises in food prices may cause or exacerbate food insecurity. If food staples are subsidized by the Government, rising import prices drain public finances and cause mounting debt levels, leading to shortfalls in spending in other key areas related to achieving the Sustainable Development Goals. Another key concern in times of rising food prices is consumer price inflation that causes an erosion of real incomes, which disproportionately affects the poor, who spend a greater share of incomes on food products. Beyond these first-order effects, a reduction in the affordability of fertilizers is likely to lessen their use in agricultural production and thereby cause a decline in yields, ultimately leading to a reduction in food availability, which would further exacerbate food insecurity.

26. Recent crises affecting global food supply chains illustrate the benefit to net food-importing developing countries of diversifying sources of food supply. Similar to commodity export dependence, strategies to reduce risks and volatility associated with food import dependence need to be tailored to country-specific conditions. In this context, policy options that could be considered include investment in the productivity and diversity of domestic food production, building food stocks to absorb short-term shocks and fluctuations, shortening food supply chains through regional food trade and diversifying both international and regional food supply markets. Developed countries and international organizations should support net food-importing developing countries in their efforts to ensure food security. This includes, in the short term, stepping up food aid and helping developing countries finance increasing food import bills. The proposal by the Food and Agriculture Organization of the United Nations of a food import financing facility is a good initiative in this regard.[26] In addition, developing countries require support in strengthening and expanding social safety nets, to limit the impact of food price rises on the most vulnerable people.

III. Summary and policy considerations

27. Commodity dependence is widespread and persistent, particularly in developing countries. Recent crises such as the pandemic and the war in Ukraine have laid bare the fragility of many commodity-dependent developing countries and net food-importing developing countries. The paramount objective of achieving the Sustainable Development Goals requires the development paths of these countries to be resilient to future shocks to global commodity markets that cause social, economic and political stress. In this regard, diversification is key to reducing vulnerability, building social and economic resilience and ensuring sustainable development.

28. In commodity-dependent developing countries, a recent period of high commodity prices could be seen as an opportunity to make progress towards diversification and value upgrading. In this context, windfall profits should be invested in horizontal enablers such as human capital and infrastructure, as well as targeted measures to promote economic dynamism in value added activities and non-commodity sectors. Since high commodity prices can be detrimental to diversification by diverting investments away from non-commodity sectors and causing exchange rate overvaluation, it is important for Governments of commodity-dependent developing countries to exercise leadership and counteract tendencies towards deepening commodity dependence. In addition, policies to promote diversification and value addition need to be embedded within a broad, integrated policy framework for sustainable development. This encompasses trade and industrial policies, as well as other key areas such as regional integration, education and competition policy. In addition to national political leadership, strong partnerships between commodity-dependent developing countries and developed countries, as well as international institutions, are needed to promote diversification and value upgrading. Such partnerships can help strengthen capacities within commodity-dependent developing countries, close infrastructure gaps and address trade barriers such as tariff peaks and escalations that limit market access for value added exports from these countries.

[26] See https://www.fao.org/3/cb9444en/cb9444en.pdf.

29. The impacts of the war in Ukraine on global commodity markets have led to significant negative effects in many net food-importing developing countries and developing countries that depend on imports of other basic commodities such as fuel and fertilizers. The share of net importers of these commodity groups is greatest among landlocked developing countries, small island developing States and the least developed countries. In particular, the rise in food prices could compromise food security in many countries and lead to a range of additional negative impacts such as fiscal imbalances and consumer price inflation. In the short term, the international community needs to limit the impact of current food price rises on the most vulnerable countries and population groups. This can be achieved by increasing humanitarian aid to affected countries and refraining from implementing ad hoc measures that further restrict or complicate food trade flows.[27] Making emergency development finance available to the most affected countries should also be a priority, as these countries will otherwise need to meet increased import bills with limited means. Over the medium-term to long-term, it is crucial for countries with highly concentrated food import structures to diversify food supply sources, to increase resilience to future shocks in global food markets. It is time to rethink food markets and explore all available options for increasing domestic food production; and to switch, wherever possible, from long supply chains to regional chains.

[27] United Nations, Global Crisis Response Group on Food, Energy and Finance, 2022, Global impact of war in Ukraine on food, energy and finance systems, available at https://news.un.org/pages/global-crisis-response-group/.