

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

# THE LEAST DEVELOPED COUNTRIES REPORT 2006

## OVERVIEW

by the Secretary-General of UNCTAD



UNITED NATIONS

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UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT  
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UNCTAD/LDC/2006 (Overview)

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## Overview

This Report is intended as a resource for policymakers in the least developed countries (LDCs) and for their development partners. Part I focuses on recent economic trends in the LDCs and the progress that those countries are making towards achieving the quantitative development targets of the Programme of Action for the Least Developed Countries for the Decade 2001–2010 (POA), agreed at the Third United Nations Conference on the LDCs (UNLDC III) held in Brussels in 2001. Part II focuses on the issue of developing productive capacities in the LDCs. The Overview summarizes the basic policy argument in a nutshell for the busy reader, and then the basic evidence upon which this argument is founded.

### THE POLICY ARGUMENT IN A NUTSHELL

#### Productive capacities matter

In recent years, many LDCs have achieved higher rates of economic growth than in the past and even higher growth of exports. But there is a widespread sense — which is apparent in the concern to ensure “pro-poor” growth — that this is not translating effectively into poverty reduction and improved human well-being. Moreover, the sustainability of the accelerated growth is fragile as it is highly dependent on commodity prices, including oil prices, trends in external finance, preferences for exports of manufactured goods, and climatic and weather conditions. In the late 1970s and 1980s, many LDCs experienced growth collapses in which gains from earlier growth spurts were reversed, and the vulnerability to this happening again remains.

Developing productive capacities is the key to achieving sustained economic growth in the LDCs. It is through developing their productive capacities that the LDCs will be able to rely increasingly on domestic resource mobilization to finance their economic growth, to reduce aid

dependence and to attract private capital inflows of a type that can support their development process. It is also through developing their productive capacities that the LDCs will be able to compete in international markets in goods and services which go beyond primary commodities and which are not dependent on special market access preferences.

Developing productive capacities is also the key to reducing pervasive poverty in the LDCs. Although aid transfers to the LDCs are increasingly being used to alleviate human suffering, substantial and sustained poverty reduction cannot be achieved with such expressions of international solidarity alone. It requires wealth creation in the LDCs and the development of domestic productive capacities in a way in which productive employment opportunities expand.

The development of productive capacities will be particularly important during the next 15 years because the LDCs are at a critical moment of transition in which they face a double challenge. Firstly, more and more people are seeking work outside agriculture and urbanization is accelerating. For the LDCs as a group, the decade 2000–2010 is going to be the first decade in which the growth of the economically active population outside agriculture is predicted to be greater than the growth of the economically active population within agriculture. This transition will affect more than half the LDCs during the decade and even more in the decade 2010–2020. Secondly, the LDCs must manage this transition in an open-economy context. As shown in earlier LDC Reports, very few LDCs have restrictive trade regimes at the present time and most have undertaken rapid and extensive trade liberalization. But their existing production and trade structures offer very limited opportunities in a rapidly globalizing world driven by new knowledge-intensive products with demanding conditions of market entry. At the same time, rapid opening up in more traditional sectors is exposing existing producers to an unprecedented degree of global competition. Benefiting from recent technological advances requires advancing towards and crossing various thresholds in human capital, R&D and management practice, which most LDC economies have lacked the resources to do. The relentless logic of cumulative causation threatens to push LDCs even further behind.

If productive employment opportunities do not expand sufficiently for the growing labour force in the LDCs — in non-agricultural activities as well as within agriculture — there will be increasing pressures for international migration from the LDCs and high levels of extreme poverty will persist. The development of productive capacities is also necessary to secure the fiscal basis for good governance and to ensure effective sovereignty. Without the development of their productive capacities, more and more LDCs will face recurrent, complex humanitarian emergencies.

### Productive capacities should be at the heart of development and poverty reduction policies

It is becoming widely accepted that the developing world needs not just lower tariffs or improved market entry, but also enhanced supply capacities in order to benefit from the open, global economy through producing and trading competitive goods and services. New international initiatives under discussion, such as “aid for trade”, recognize that without productive capacities there will be little to trade and that these capacities will not emerge automatically from the workings of market forces alone, but from the interplay of entrepreneurship, public policy and international action. To the extent that the “aid for trade” initiative results in increased aid for, inter alia, export supply capacities, this is a move in the right direction.

However, in general, national and international policies do not adequately address the challenge of developing productive capacities in the LDCs. There is a need for a paradigm shift which places the development of productive capacities at the heart of national and international policies to promote development and poverty reduction in the LDCs.

Productive capacities are defined in this Report as *the productive resources, entrepreneurial capabilities and production linkages which together determine the capacity of a country to produce goods and services and enable it to grow and develop*. For tradable goods and services, what matters is the capacity to produce in an internationally competitive

manner. Productive capacities develop within a country through three closely interrelated processes: capital accumulation, technological progress and structural change. Capital accumulation is the process of maintaining and increasing stocks of natural, human and physical capital through *investment*. Achieving technological progress is the process of introducing new goods and services, new or improved methods, equipment or skills to produce goods and services, and new and improved forms of organizing production through *innovation*. Structural change is the change in the inter- and intrasectoral composition of production, the pattern of inter- and intrasectoral linkages and the pattern of linkages amongst enterprises. Such change often occurs through investment and innovation, and the emerging production structure in turn influences the potential for further investment and innovation.

To put productive capacities at the heart of development and poverty reduction policies means to focus on promoting capital accumulation, technological progress and structural change in the LDCs. National and international policies should seek to start and to sustain a virtuous circle in which the development of productive capacities and the growth of demand mutually reinforce each other. This should be done in a way in which productive employment opportunities expand in order to ensure poverty reduction.

### Developing productive capacities requires new policy orientations

This paradigm shift is not something totally new. But it would be a new policy orientation for the LDCs and their development partners, even though developing productive capacities is part and parcel of the Brussels Programme of Action for the LDCs. It would entail a production- and employment-oriented approach to poverty reduction which would encompass, rather than be narrowly focused on, increasing social sector spending and achieving human development targets. It would also entail a development-driven approach to trade rather than a trade-driven approach to development. An approach to developing productive capacities which is simply trade-centric will not be sufficient for sustained and inclusive growth in the LDCs.

The paradigm shift would also strengthen current efforts to develop productive capacities in the LDCs — such as in policies to improve their investment climate — through:

- Macroeconomic policies oriented to promoting growth, investment and employment;
- A multi-level approach which not only seeks to set the framework institutions and macroeconomic environment, but also includes policies to change meso-level production structures and institutions, as well as micro-level capabilities and incentives;
- An active approach to promoting entrepreneurship;
- A strategic approach to global integration in which the speed and degree of liberalization in different economic spheres take account of the goal of developing productive capacities.

National and international policies to develop productive capacities in the LDCs should prioritize the relaxing of key constraints on capital accumulation, technological progress and structural change. The identification of key constraints needs to be done on a country-by-country basis. However, one consequence of the combination of a deficiency of domestic demand on the one hand, and of weak capabilities, infrastructure and institutions for being internationally competitive on the other hand, is that productive resources and entrepreneurial capabilities are underutilized within the LDCs owing to lack of demand and structural weaknesses. There is surplus labour, latent entrepreneurship, untapped traditional knowledge, a vent-for-surplus through exporting and unsurveyed natural resources. Policy thus needs to be geared to mobilizing these underutilized potentials. As Albert Hirschman has put it, “Development depends not so much on finding optimal combinations for given resources and factors of production as on calling forth and enlisting for development purposes resources and abilities that are hidden, scattered, or badly utilized”

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