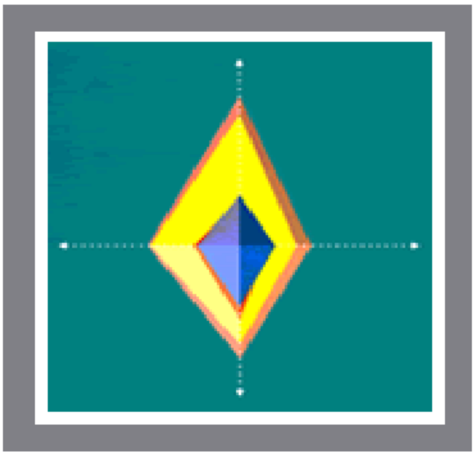
UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

THE LEAST DEVELOPED COUNTRIES
1996 REPORT

OVERVIEW
by the Secretary-General of UNCTAD



UNITED NATIONS
New York and Geneva, 1996

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The Least Developed Countries 1996 Report (UNCTAD/LDC(1996)/Overview

OVERVIEW: LDCS IN A GLOBALIZING WORLD ECONOMY

INTRODUCTION

The growing interest in both official and private quarters in the phenomenon of globalization and its companion, the process of economic liberalization, has generated much thinking and analysis about its origin, its impact on economies and societies, and on the pattern of its likely evolution. Although much publicity has surrounded some of the analysis, it is clear that these multifaceted phenomena have important implications which governments, businesses and analysts all over the world must address. Much of the analysis and thinking has focused on the more visible aspects of globalization, notably, the sea-changes taking place in the pattern of production, pace of diffusion of knowledge and information and in the convergence of factor markets. Less well understood and analysed, however, is the phenomenon of marginalization.

It is far from clear how those economies and societies, including most of the LDCs that are at the periphery of global processes - and have been so over very long periods - will be affected by the recent trends. Questions such as whether globalization will assist their integration in the world economy or whether the new challenges will further weaken their already precarious links are far from academic but are at the centre of the development policy debate. There is a danger that the fragile economic and social position which characterizes many of the LDCs will deteriorate further unless major efforts are made by the LDCs, supported by the international community, to adjust to the challenges of globalization and liberalization.

The paragraphs that follow address some of these issues and attempt to outline the key role of designing appropriate policies to meet the challenges. While the discussion stresses the LDCs' perspectives, it nevertheless has relevance for other poorer economies and indeed for wider global community.

Globalization and Liberalization

The world economy is increasingly being shaped by the processes of globalization and liberalization. These are interrelated and multifaceted processes encompassing the growth of international trade in goods and services and capital flows, the global integration of production processes, the dominance of market-oriented economic policies throughout the world, and a significant degree of institutional harmonization between countries in respect of trade, investment and other policies mediated through multilateral and regional institutions. Globalization and liberalization are processes that are unlikely to be reversed in the foreseeable future and have profound implications for LDCs in terms of their position in the world economy, their development prospects and the nature of their economic policies.

Integration of Developing Countries into the World Economy

Many countries in the developing world have made substantial progress in economic development over the course of the last two to three decades. Progress has been most marked in East Asia, but has not been confined to this region. The successful developing countries (DCs) have achieved rapid rates of economic growth, established internationally competitive industries, gained a growing share of world export markets, attained high rates of investment in physical and human capital, and have begun to close the disparities in income between themselves and the industrialized countries. Integration into the global economy has facilitated the development efforts of these countries, particularly through the opportunities it has provided them to accelerate the growth of their exports and to access foreign capital and technology. Globalization, however, may have converse effects for some of the weaker DCs, and, in particular, could lead to their marginalization.

Marginalization of the LDCs

While many DCs have assumed an increasingly prominent role in the global economy, many of the LDCs are becoming marginalized from the mainstream of the world economy. Marginalization is the consequence of the combination of developments in the global economy that have not been favourable to weaker economies, such as the LDCs, or to their internal political and economic problems. These two sets of factors have interacted to reinforce their marginalization.

As a group, the LDCs have not fared well in terms of economic development over the last two decades, although some individual countries have made significant progress. Economic growth has been very slow and has failed to keep pace with rapid population growth, as a consequence of which per capita incomes and living standards have declined and poverty has intensified.

The marginalization of a significant number of the LDCs from the mainstream of the world economy is reflected in an array of important economic and social indicators. Not only have LDC growth rates lagged behind those in other DCs since the early 1970s, but the LDCs' share of world exports and imports has fallen sharply. The LDCs have attracted a negligible share of global flows of foreign investment, and their investment rates, as a percentage of GDP, have been much lower than the average for all DCs. They have achieved very little structural change and remain heavily dependent upon primary commodities for export earnings and on official development assistance (ODA) to finance a large share of their investment and government budgets.

Growing Income Inequalities

A related manifestation of the marginalization of the LDCs is the increasing income disparities between them and both the industrialized countries and other DCs. The differential in per capita incomes between the countries with the poorest 20 per cent of the world population (a group that consists mainly of the LDCs) and the richest 20 per cent widened considerably between 1960 and 1991, as did the disparity between the poorest countries and those in the middle range of the income distribution (see the box below). Conversely, income disparities between the industrialized countries and the middle range of the income distribution have narrowed, reflecting the economic advances made by many of the DCs.

Reasons Underlying the Poor Economic Performance of the LDCs

The poor economic performance of the LDCs, both in absolute terms and relative to that of other DCs, reflects the impact of a number of factors. About one third of the countries in the LDC group have been afflicted by acute civil strife and political instability which have severely retarded development efforts and, in some cases, have had devastating economic and social consequences. Restoring peace and security is imperative if development is to begin again in these countries. In other LDCs, a range of problems relating to structural constraints, adverse external shocks, such as depressed commodity prices and the debt crisis, and policy weaknesses have impeded development efforts. Most of these countries have implemented policy-reform programmes in recent years designed to liberalize their economies and to enhance their integration into the international economy. Policy reforms have made some impact in terms of economic stabilization, but in most LDCs have yet to stimulate the significant acceleration of growth rates that is required to revive their economies.

This report argues that the processes of globalization and liberalization offer LDCs important long-term opportunities to reverse the economic decline that they have experienced over the last two decades, but that these processes also raise serious concerns for these countries. In the absence of appropriate policy responses from the LDCs and the international community, globalization and liberalization may do little to alleviate the trend towards their marginalization from the world economy and may even accentuate it.

Opportunities for LDCs in the Global Economy

The opportunities provided by globalization and liberalization arise mainly from changes in the global economy which are likely to enhance market opportunities for LDCs’ exports, and may stimulate increased foreign investment. Growth in world trade is expected to be robust over the next decade as a result of the Uruguay Round trade liberalization and the growth of new markets in the transitional and developing economies, which should stimulate demand for LDCs’ exports. It is also likely that new markets will emerge for LDCs to develop niche exports in areas such as horticulture and tourism, and that as wages rise in the newly industrialized economies (NIEs), labour-intensive manufacturing exporters may relocate to LDCs to take advantage of lower labour costs, which would provide a stimulus for export diversification in the LDCs. Integration into world markets offers major advantages for LDCs, not least because their own domestic markets are too small to provide viable investment opportunities for many potential investors. However, LDCs may not be able to exploit the opportunities offered by globalization because of pervasive supply-side constraints.

Supply-side Constraints

The ability of LDCs to take advantage of the emerging opportunities in world markets depends crucially on their ability to foster the development of internationally competitive industries which can meet exacting standards of cost, quality, reliability and delivery schedules. Supply capacities in LDCs are, however, very weak for a variety of reasons and this is likely to be the major constraint on their ability to exploit the opportunities arising from globalization. In particular, the private-enterprise sector, which is the key agent of development, is not well developed in most LDCs and its growth is constrained by shortages of capital and of entrepreneurial, managerial, technical and marketing skills. Technological capacities in many industries in LDCs are rudimentary, which, together with the low levels of educational attainment of the workforce, is a major impediment to raising productivity. Some of the services necessary to support production, such as the provision of adequate finance or marketing services, are often lacking or are very expensive. There are serious deficiencies in the physical infrastructure with the land-locked countries, in particular, facing very high transport costs to access international markets. Supply-side constraints have always been an impediment to development in the LDCs, but their importance has been heightened by globalization and liberalization because of the increasing premium on the efficient production of traded goods.

Risks for LDCs from Intensified Competition

Globalization and liberalization present a number of potential dangers for LDCs which, unless they can overcome the supply-side constraints discussed above and improve the productivity of their industries, threaten to accentuate their marginalization in the world economy, which is becoming more competitive as protected markets are increasingly opened up by liberalization and as competition among exporters is boosted by new entrants emerging from previously closed transitional and developing economies. Consequently, LDCs will face intensified competition in their major export markets in the industrialized countries and in their own domestic markets. This competition is potentially problematic for LDCs because many of their industries, especially those that were established to serve protected markets, are likely to be less efficient than their competitors and may lack the resources required to improve efficiency to the levels necessary to compete. LDCs may therefore suffer a further erosion of their share of world export markets and a possible loss of domestic market share to increased import competition.

Costs and Benefits of the Uruguay Round for LDCs

The imperatives of global integration have provided the stimulus for the conclusion of the Uruguay Round of reforms to the multilateral trading system. This is likely to provide a significant stimulus to world trade and therefore potentially enhance trading opportunities for LDCs. Although reaching definitive conclusions as to the costs and benefits of the Uruguay Round Agreements for particular countries is difficult at this stage, the major gains are likely to accrue to the industrialized countries and NIEs that have already established internationally competitive industries and which are thus in a position to compete in liberalized markets, rather than to the LDCs.

The Uruguay Round may also impose costs on LDC economies through a number of channels. As a result of Uruguay Round MFN tariff cuts, the LDCs will suffer an erosion of tariff preferences in their export markets: these are provided under GSP schemes and (for those LDCs which are members of the ACP group) the Lomé Convention. However, preferences *per se* have not been very effective in boosting LDC exports in the past and their reduction therefore may have limited practical impact. Agricultural liberalization in the industrialized countries is likely to induce a rise in world food prices. As many LDCs are net food importers, this will have an adverse effect on their terms of trade as well as on domestic food security. There may also be costs for the LDCs arising from compliance with notification requirements, policing various agreements and in participating in WTO activities. Some of the LDCs' potential concerns were acknowledged in the Final Act of the Uruguay Round which provided them with special and differential treatment allowing them greater flexibility and a longer time-frame to comply with multilateral commitments.

Constraints on Access to Foreign Capital

More than any other group of DCs, the LDCs are heavily dependent upon external finance to fund trade deficits, supplement government budgets and finance investment. The major sources of external finance for the LDCs are concessional funding from official sources and foreign direct investment (FDI). But their marginalization risks undermining their access to both sources of external finance.

Because their domestic private sectors are so weak, LDCs require the capital, technology and skills that FDI can provide if they are to improve supply capacities in their industries. Foreign investment in the developing countries has risen markedly in the last few years, but very little of it has been directed towards the LDCs. Their share of the total FDI flows to all DCs amounted to only 1.1 per cent in 1992-1994. FDI has been concentrated in the richer and more dynamic DCs, especially those in East Asia and Latin America. Furthermore, some foreign companies have been disinvesting from some LDCs in Africa in order to refocus their operations on other regions of the world where economic prospects are regarded as more promising.

As part of wider programmes of economic reform, many LDCs have reformed their investment policies in an attempt to attract FDI. But foreign investment in these countries is deterred by a variety of factors not readily amenable to policy reforms: the small size of the domestic market, inadequate infrastructure, falling world prices for primary commodities, and, in some cases, political instability.

With limited access to private capital, the role of ODA in meeting LDCs' external financing needs has assumed even greater importance. ODA flows to LDCs have, however, stagnated in the last few years. Some of the donors have re-prioritized their aid commitments, for political or commercial reasons, away from the LDCs. With the end of the cold war, most of the LDCs no longer have much strategic significance for the major donors and are perceived as providing few commercial opportunities for firms from the donor countries, while political instability has severely reduced the absorptive capacity for external finance in some LDCs. Hence, LDCs are facing severe constraints on their access to concessional finance at a time when enhanced flows of external resources are most needed.

Trends in World Commodity Markets

Most LDCs remain dependent upon exports of primary commodities to generate their foreign-exchange earnings. Trends in world commodity markets since the 1970s, however, have not been favourable to LDCs. There has been a long-run decline in the real prices of many of the commodities which are of particular importance to LDCs, such as coffee, copper, cotton and tea. This reflects the fact that the growth in world market demand for primary commodities has lagged behind that of other products, partly because of a fall in the commodity intensity of final expenditures, while supply has been boosted by productivity increases linked to the application of new technology in some important supplier countries. It is possible, but by no means certain, that the demand for some primary commodities, especially metals, minerals and agricultural raw materials, may pick up over the medium term because of the rapid economic growth in Asian countries where the demand for raw materials is outstripping supply.

The LDCs have also lost market share in the world markets for many of their major primary commodity exports, including coffee, copper, metals and minerals because of domestic production constraints and productivity improvements in competitor countries. Reversing this trend in their market share is imperative if the LDCs are to participate more fully in the global economy.

Regional Trading Arrangements

Despite the multilateral agreements reached under the Uruguay Round, the growth of regional trading arrangements (RTAs) has accelerated, with new RTAs being established, the membership of existing RTAs expanded, and formal links established between different RTAs. Most LDCs are themselves members, together with other DCs,