UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

Export Competitiveness and Development in LDCs: Policies, Issues and priorities for Least Developed countries for action during and beyond UNCTAD XII

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Abstract:

For the last several decades, the least developed countries (LDCs)[1] have been pursuing wide-ranging economic policies and strategies, mainly in the context of the Structural Adjustment Programmes and lately, Poverty Reduction Strategy Papers (PRSPs). Trade liberalization and integration remained a central focus and an essential component of development policies and strategies of LDCs. Unfortunately, the extensive policies and measures undertaken by these countries have not generated, as yet, the form and quality of growth required to reverse their continued marginalization in the world economy. Their persistent under-development and in many cases, long term decline, illustrates how trade and integration may be necessary but not sufficient for development and poverty reduction in LDCs. This is due to the interplay of external and internal development challenges and problems facing them. The present study argues that, despite the many and complex obstacles they face, there is considerable scope for many LDCs to join the group of successful exporters particularly in traditional exports such as oil, copper, coffee, cocoa and groundnuts. It further emphasized three important areas of non-traditional exports with significant growth potential for LDCs: horticulture, fishing and tourism. There could also be dynamic gains particularly in traditional exports and horticulture, notably in the form of technological upgrading, quality control, marketing networks and market connections.

Key words:

Export competitiveness, trade policies, challenges and opportunities, LDCs, UNCTAD XII

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[1] The 50 countries that currently belong to the group of LDCs are: Afghanistan, Angola , Bangladesh, Benin, Bhutan, Burkina Faso , Burundi , Cambodia , Cape Verde , Central African Republic , Chad , Comoros, Democratic Republic of the Congo,. Djibouti , Equatorial Guinea, Eritrea , Ethiopia , Gambia , Guinea , Guinea-Bissau , Haiti , Kiribati,. Lao People's Democratic Republic, Lesotho, Liberia, Madagascar, Malawi, Maldives, Mali, Mauritania, Mozambique, Myanmar, Nepal, Niger, Rwanda, Samoa, Sao Tome and Principe, Senegal, Sierra Leone, Solomon Islands, Somalia, Sudan, Timor-Leste, Togo, Tuvalu,. Uganda, United Republic of Tanzania, Vanuatu, Yemen, Zambia.

Acknowledgement

This publication is the outcome of the UNCTAD project (INT/OT/BP,which was designed to assist least developed countries in their participation in the preparatory process for and at the 12th session of the United Nations Conference on Trade and Development (UNCTAD XII). The Conference is scheduled to take place in Accra (Ghana) in April 2008. The project was implemented by the financial support of the Governments of Austria and Norway to which the secretariat wishes to express its sincere gratitude.

The project was implemented by Mussie Delelegn and Jean-Claude Mporamazina under the overall supervision of Mr. Habib Ouane, Director, Division for Africa, LDCs and Special Programmes of UNCTAD. Marcel Namfua, Massoume Sahami, Janvier Inkuruziza and Antipas Touhatam have provided support to the overall implementation of the project. Messrs[2] Stephen A. O'Connell, Stephen Golub and Wenxin Du have provided consultancy services to the project and produced chapter I of the publication.

Mathias Pofagi (Benin), Sonam Wangchuk (Bhutan), Célestine Bere Lompo (Burkina Faso), Dismas Baransaka (Burundi), Hamacire Dick (Mali), Lourenço Sambo (Mozambique), Andre Habimana (Rwanda), Cherif Salif Sy (Senegal) and Lindani Ndlovu (Uganda) prepared case studies[3] on their respective countries. The case studies were presented at the Expert Meeting of LDCs which was convened, as part of the project, in Aruhsa (United Republic of Tanzania) on 22-24 October 2007. The Expert Meeting-the outcome of which forms chapter IV of this report- was opened by H .E. Mr. Basil Mramba, Minister of Trade, Industry and Marketing of Tanzania and was chaired by H. E. Mr. Arsene Balihuta, Ambassador and Permanent Representative of Uganda in Geneva. Fredrik Arthur (Norway), Elisabeth Marschang and Georg Zehetner (Austria) were involved in the various stages of the project and contributed to its smooth implementation.

Secretarial and administrative support to the project and in the final preparation of the report was provided by Corazon Alvarez, Paulette Lacroix, Rajalingam Madasamyraja and Regina Ogunyinka.

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[3] The case studies are available at: http://www.unctad.org

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Foreword

UNCTAD's highest decision-making body - the United Nations Conference on Trade and Development- meets every four year. The 11th Conference (UNCTAD XI) took place in Sao-Paulo (Brazil) in June 2004 and adopted the Sao-Paulo Consensus- the outcome document that guides the engagement of UNCTAD in advancing the trade and development interests and objectives of developing countries in an increasingly interdependent and globalizing world economy. The 12th session of the United Nations Conference on Trade and Development (UNCTAD XII) will take place in Accra (Ghana) in April 2008. UNCTAD XII will deliberate on the agreed theme and sub-themes[4], dealing with trade and development challenges, prospects, policies and strategies, particularly from the perspectives of developing countries. At the conference Member states are expected to reach consensus on desirable policies and strategies for action at the national, regional and international levels as well as adopt the programme of work for the UNCTAD secretariat for the subsequent years.

The participation of the Least Developed Countries in major conferences and summits - despite improvements over the recent years- is still weak and a lot remains to be done. Their effective participation in such global conferences and summits like UNCTADXII requires, among other things, an adequate assessment of their needs and a clear identification of their common interests during the preparatory process and at the Conference. To that end, the UNCTAD secretariat designed and implemented a project (INT/OT/5BP-MTR) aimed at contributing to the improved and informed participation of LDCs in the preparatory process for and at UNCTAD XII. The project assisted LDCs in undertaking comprehensive assessment of their needs and a clear identification of their collective interests for action at the national and international levels.

This publication, which is the direct outcome of the project, is expected to contribute to a better understanding of the complexities of development challenges, prospects and potential existing in least developed countries. Chapter I attempts to address and respond to broader policy issues such as: what should be done to assist LDCs improve their export competitiveness and advance their development objectives? The analysis and policy conclusions of this chapter are based on specific case- studies undertaken on various export items and sectors of strategic interest to the least developed countries. These includes analysis of specific case studies on: coffee, cotton, clothing, groundnuts, fishing, horticulture, tourism, oil and mining, Chapter II, secion A the national case study on Uganda- provides succinct analysis of the country's development experience including its recent trade performance, the challenges remaining and the policy responses or interventions needed at the national, regional and international levels. Whereas section B- the case study of Rwanda describes the potential for grwth and trade expansion, the challenges facing Rwanda and the policy recommendations required to address the existing gaps. Chapter III provides policy conclusions and lessons learned and the last chapter, Chapter IV sets out the negotiating proposals for LDCs as adopted by the expert meeting convened, as part of the project, in Arusha Tanzania on 22-24 October 2007.

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[4] The Trade and Development Board at its 54th regular session established the Preparatory Committee for UNCTAD XII and negotiations on the agreed theme and sub-themes of the Conference have started immediately after. The theme of the Conference is " Addressing the opportunities and challenges of globalization for development" and has four sub-themes: Sub-theme I (Enhancing coherence at all levels for sustainable economic development and poverty reduction in global policy making, including the contribution of regional approaches) .Sub-theme II (Key trade and development issues and the new realities in the geography of the world economy); Sub-theme II (Enhancing the enabling environment at all levels to strengthen productive capacity, trade and investment: mobilizing resources and harnessing knowledge for development); and Sub-theme IV (Strengthening UNCTAD; enhancing its development role, impact, and institutional effectiveness).

The series of sector- specific case studies and selected national case studies greatly converge in their critical but constructive assessment of development challenges, potential and opportunities existing in LDCs. They highlighted, in particular the complexity and inter-related nature of the challenges, which undermine the potential and national policy efforts to achieve the objectives of sustained growth and development. Some of the problems are internal, while others are external in nature. The internal ones are largely related to the weak productive capacities, underdevelopment, institutional weakness, problems related to economic management and mass poverty. The external barriers include: market access and entry problems, paucity of external resources flows, including FDI, little or no transfer of technology and know-how, and uncoordinated donor policies. In some cases, regional integration processes have also created complex rules of origin, resulting in trade loss and high transaction cost. For instance, while there are more than 30 regional or sub-regional economic groupings and trading blocs in Africa alone, inter African trade accounts for less than 10 per cent of the total trade of LDCs. Furthermore, Case studies from Bhutan, Burkina Faso, Burundi, and Rwanda emphasized remoteness from the regional and international markets, high cost of transportation and lack of transit-transport systems as detrimental to their export competitiveness and development. The case study of Sudan also argues that "Sudan is partly a landlocked country, given its vast geographical size and the distance between its southern region and Port-Sudan in the north of the country".

I. Export Competitiveness and Development in LDCs

A. Introduction

An increasing number of developing countries have benefited from integration in the global economy through export growth and diversification:

- the Asian "tigers" Korea, Taiwan, Singapore and Hong Kong, whose export-led growth starting in the 1960s has vaulted them into the status of developed nations;
- the South East-Asian countries such as Malaysia, Thailand and Indonesia starting in the 1970s;
- more of South East Asia in the 1990s and 2000s, including Vietnam, Cambodia, and of course most dramatically China;
- in South Asia, India and Bangladesh;
- in Latin America, Chile and Costa Rica;
- and in Africa, Tunisia, Mauritius and Botswana.

In most but not all of these instances, export promotion played a critical role in long-run growth, by supporting a virtuous circle of investment, innovation, and poverty reduction. Most of these countries transitioned from dependence on primary products to becoming important manufactured exporters, but manufacturing exports are not the only route to export growth, as seen by Chile's success in horticulture and India's in office services. Even primary products, if managed carefully, can serve as an engine of growth, as in Botswana and Indonesia.

Global opportunities are highly variegated and sectors with high potential will differ across countries, reflecting differences in factor endowments, locational advantages, and scale or agglomeration effects. The linkages of exports to growth and poverty reduction will also differ, in some cases operating mainly through employment and learning effects at the firm and industry level, in others through expanded financing for public infrastructure or imported capital equipment, and in others through the use of export promotion to achieve focused improvements in public services and the business environment (Biggs 2007). The strength of these channels, and the time scale over which they operate, will also differ. Strong near-term opportunities are open to coastal and labor-abundant economies like Bangladesh, Senegal, and Tanzania, while deeper challenges face landlocked and resource-scarce economies like Burundi and Malawi and economies dominated by mineral exports like Zambia and (soon) Timor-Leste.

As Collier (2007) argues that, however, about a billion people in developing countries have been bypassed by the global economy, due to a combination of geographical handicaps, civil wars, and poor governance. In many cases, these countries have undergone two decades of structural adjustments, with little progress to show. Given this context, the question that should be seriously examined by LDCs and their development parteners is: can exports help drive development in the weakest economies of the world? By comparison with the rest of the developing world, the least developed countries (LDCs) are small, remote from high-income markets, lacking in physical infrastructure, and short of skilled manpower. Private businesses face high transactions costs, and the security of property is weak. On a global basis, these characteristics have been associated with slow economic growth and declining shares of world exports. Moreover, the LDCs face external hurdles in the form of protected and subsidized markets in developed countries and the formidable competition of China, India and other established Asian exporters.

As Adrian Wood and associates have argued, increased international capital mobility sharpens the impact of location-specific characteristics like natural resources in determining the location of production and the structure of comparative advantage (Wood and Berge 1997; Owens and Wood 1997; see also Jones 1980). Meanwhile agglomeration effects and preference erosion reinforce the advantages of established exporters like China in the markets for labor-intensive manufactured goods. Hausmann, Hwang and Rodrik (2007) argue that the exports of low-income developing countries are dominated by sectors with weak productivity spillovers, suggesting a circular chain of causation from trade to specialization to low growth. These contributions jointly suggest that what international markets mainly have to offer LDCs is a deepening 'natural resource curse' (Sachs and Warner 2002).

The thesis of this chapter is that there is considerable scope for many LDCs to join the group of successful exporters, despite the significant external and internal obstacles they face. Some are in fact already doing so. Virtually all have removed the most egregious forms of anti-export bias and many have begun the arduous process – critical to manufacturing success but of fundamental relevance for other sectors as well – of improving the institutional environment for private-sector investment and addressing supply-side constraints. Collier (2007) and Collier and Venables (2007) rightly emphasize the importance of trade preferences in jump-starting the manufacturing sector in some LDCs; preference margins remain substantial in textiles and apparel, and countries with potential comparative advantage in these areas have an intense interest in securing more liberal rules of origin. We will argue, however, that substantial opportunities also exist in horticulture, fishing, and tourism, where preferences are less relevant. Countries can also benefit much more from traditional exports than they have until now. The 'resource curse' is a sobering challenge but as Collier (2007) emphasizes, it applies much more strongly to large and spatially concentrated commodity rents than to primary exports *per se*. Traditional agricultural crops such as cotton and coffee, like horticulture, have much in common with manufacturing in generating dynamic gains in the form of technological upgrading, quality control, marketing connections stressed by Hausmann and Rodrik (2003). To a lesser extent, learning and efficiency gains are also possible in mining and energy industries; for the latter, however, coming to grips with the resource curse is the most important condition.

While foreign assistance can contribute to export development in all sectors, the fundamental requirement for success is that LDCs alleviate the supply constraints and governance failures that have held them back to date. The approach in this chapter is to examine case studies across a range of export sectors of major interest to LDCs. The findings suggest considerable grounds for optimism for those countries whose governments are able to commit to the necessary institutional and policy reforms at the macroeconomic and industry levels.

Section 2 below provides a brief overview of the position of LDCs in the global economy, emphasizing broadly favorable developments of the past decade and the diversity of country experience. Sections 3 and 4 then discuss the evolving policy and institutional environment for exports, starting with regional and global issues and then turning to developments in the national policy environment. Sections 5 through 8 provide case-study evidence to examine the nature of export opportunities and the determinants of success and failure in each of 4 major sectors (traditional primary exports, non-traditional agricultural exports, manufacturing, and tourism). Section 9 summarizes the findings and policy recommendations.

B. LDCs in the Global Economy

Most LDCs are African, and the group includes only one country from the Americas (Haiti). Most are highly dependent on aid. But in many respects relevant to its integration with the world economy, the group is highly diverse. Among Asian countries, coastal and labor-abundant countries like Bangladesh and Vietnam have joined the ranks of manufacturing exporters, and in Africa Madagascar, Lesotho, and some others have begun to follow suit. The African group includes a disproportionate number of landlocked countries and countries in which exports are dominated by mineral rents (Collier and O'Connell 2007). In this section we briefly review the global position of LDCs as exporters and recipients of financial flows.

i. Exports

Trade has grown faster than GDP on a worldwide basis since the 1960s, particularly among developing-country exporters of manufactured goods. Until the mid-1990s, however, LDC exports grew more slowly than exports from other developing countries. Total GDP followed similar pattern of increased marginalization, and as many observers have noted, these observations are two sides of the same coin (Bacchetta 2007). As of the mid-1990s the LDCs as a group accounted for 10.1 percent of the total population of developing and industrial countries but contributed only 0.46 percent of total merchandise exports and the same 0.46 percent total GDP.* This relative decline was arrested after the mid-1990s, however, and by 2004/05 the LDC shares of merchandise exports and GDP had risen to 0.72 and 0.62. The share of LDCs in exports of services continued to decline after the mid-1990s, but at a considerably slower rate than over the previous decade and, as we will see, tourism exports increased sharply.

Group totals are often dominated by the performance of a few large countries. Angola's oil exports, for example, constituted over 30 percent of total LDC merchandise exports in 2004/05. Cross-country averages or medians convey a better sense of the 'typical' country experience, and for this reason we employ them for the remainder of this section. Table 1 shows median values for the growth rates of the real purchasing power of exports and real GDP per capita for three country groups since the mid-1980s. The median LDC improved sharply in terms of export growth and overall economic growth by comparison with the decade after 1984/85, both in absolute terms and relative to the rest of the world. Export tended to rise slightly faster than GDP among the LDCs between 1985 and 1995, but this was in a context of very slow growth in both variables: median real GDP per capita in the LDCs actually fell in the decade following 1984/85. By contrast, after 1994/95 both growth and exports picked up speed, with LDC performance on these variables virtually matching that of the industrialized countries.

Table 1. Merchandise exports and growth performance

		Within-group medians		
Period and country group	**n**	**Growth rate of real US$ merchandise exports (%)**	**Growth rate of real GDP per capita, constant LCU (%)**	**Increase in export/GDP ratio (% points)**
	(1)	*(2)*	*(3)*	*(4)*
1984/85 to 1994/95				
LDCs	36	0.73	-0.44	1.98
Other DCs	75	4.05	1.65	1.61
Indust	22	6.45	1.90	-1.19
Total	133	4.12	1.33	1.42
1994/95 to 2004/05				
LDCs	36	3.94	1.56	0.27
Other DCs	75	5.06	1.76	4.78
Indust	22	3.79	2.08	2.24
Total	133	4.50	1.81	3.01

Notes: The table includes all countries with data on all variables in 1974/75, 1984/85, and 2004/05. Real exports are calculated as nominal exports divided by the US GDP deflator: export growth rates therefore reflect both volume increases and terms of trade effects.
Source: Exports and GDP (both in US$), and real GDP per capita (constant local currency units) from World Bank, *World Development Indicators* online; US GDP deflator from IMF, *International Financial Statistics* online.

* Data limitations are severe, particularly among LDCs. To avoid compositional effects, all calculations in this section exclude transition economies and are limited to countries with the required data available in all relevant periods. The calculations reported in this sentence, for example, employ a sample that consists of the 45 LDCs, 81 other developing countries, and 23 industrial countries for which trade and GDP data are available in both 1994/95 and 2004/05. Merchandise exports in US$ and PPP-adjusted real GDP are from the World Bank's *World Development Indicators online*.

The exports of LDCs continue to be dominated by primary products, and favorable movements in world commodity prices – including conspicuously oil, copper and coffee among others – have recently played an important role in boosting export revenues and encouraging inward FDI in a number of LDCs. This has occurred against the background of a long-run trend of diversification of export revenues away from primary commodities. Table 2 uses World Bank data to provide a more recent breakdown for the 17 LDCs with complete data starting in the mid-1990s. The long-run trend out of primary commodities is arrested only after 2000, when a sharp increase in the 'fuels, minerals and metals' share more than offsets a substantial decline in agricultural exports. Some portion of this reversal is likely to prove persistent, given strong world demand for extractive exports, large FDI flows into extractive industries in some LDCs, and an erosion of preferences in industrial-country markets for low-tech manufacturing goods. Transitory shocks to world commodity prices and to agricultural supply in LDCs (including droughts and high oil prices) may also be driving some of the volatility apparent in Table 2.

Table 2. Composition of merchandise exports

Period and Country group	**n**	**Broad Primary (%)**								**Narrow Manufacturing (%)**
		Agriculture			**Energy and mining**			**Total**	
		Agri Raw Materials	**Food**	**Total**	**Fuels**	**Ores and minerals**	**Total**		
	(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*	*(7)*	*(8)*	*(9)*
1994/96									
LDCs	17	15.4	36.4	51.8	8.3	14.8	23.1	74.9	24.3
Other Developing	64	4.4	29.7	34.1	17.3	5.7	23.0	57.1	41.6
Industrial	22	3.7	15.5	19.2	5.8	4.0	9.8	29.0	68.2
Total	103	6.1	27.8	33.9	13.4	6.9	20.3	54.2	44.4
1999/2000									
LDCs	17	14.4	36.4	50.8	10.6	9.4	20.0	70.8	28.0
Other Developing	64	3.5	26.4	29.9	19.7	5.0	24.7	54.6	44.7
Industrial	22	2.7	13.5	16.2	6.6	4.2	10.8	27.0	70.3
Total	103	5.1	25.3	30.4	15.4	5.5	20.9	51.3	47.4
2003/05									
LDCs	17	14.6	30.6	45.2	13.7	15.0	28.7	73.9	25.3
Other Developing	64	3.3	25.3	28.6	20.5	5.6	26.1	54.7	44.4
Industrial	22	2.5	13.0	15.5	8.0	4.4	12.4	27.9	68.9
Total	103	5.0	23.6	28.6	16.7	6.9	23.6	52.2	46.5

Notes: Table entries show unweighted cross-country averages of the share of the column in merchandise exports, based on data for the categories in columns 2, 3, 5, 6, and 9.The table excludes an 'Newly Emerging Countries' category that is not available for all countries but accounts for only 1.5 and 1.4 percent of merchandise exports in 1994/96 and 2004/05 respectively (0.8, 0.9 and 3.2 percent for LDCs, Other Developing, and Industrials, in 2004/05). Each underlying country/period observation is a 2- or 3-year average for that period using all available data for the period 3. The table includes all countries for which an observation is available on all variables in all five categories for all periods reported.

Sources: Exports in nominal US$ from World Bank, *World Development Indicators* online.

Table 3 looks at exports of non-factor services. Overall, services have commanded a slightly higher share of export receipts among LDCs than among other countries. Tourism is of particular importance; travel services accounted for more than half of overall commercial service exports among LDCs in 2003/05 and have increased rapidly since (at least) the mid-1980s, both as a share of services and as a share of total exports.

Table 3. Size and composition of service exports

Period and country group	Composition of total exports				Composition of service exports (%)				
	n	Ratios to GDP (%) Merch exports	Ratios to GDP (%) Service exports	Serviceexports as share of total exports (%)	n	CCO	IF	Transp	Travel
	(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*	*(7)*	*(8)*	*(9)*
1984/85									
LDCs	23	13.9	7.0	26.9	19	28.1	1.6	24.8	45.5
Other DCs	67	28.3	10.0	23.1	62	26.9	3.2	28.1	42.7
Indust	22	25.8	6.6	21.0	22	32.9	8.4	25.6	33.2
Total	112	24.9	8.7	23.5	103	28.4	4.0	26.9	41.2
1994/95									
LDCs	23	15.1	9.1	32.0	19	26.0	2.1	23.9	48.0
Other DCs	67	29.6	12.8	28.3	62	26.4	4.2	25.0	44.4
Indust	22	25.9	6.9	22.5	22	34.8	10.5	24.5	30.2
Total	112	25.9	10.9	27.9	103	28.2	5.1	24.7	42.1
2004/05									
LDCs	23	18.8	8.7	29.9	19	24.1	2.3	20.0	53.6
Other DCs	67	36.3	13.7	28.6	62	25.1	5.4	24.8	45.0
Indust	22	30.1	9.9	26.2	22	38.3	10.2	23.4	28.0
Total	112	31.5	11.9	28.4	103	27.7	5.8	23.6	42.9

Notes: CCO = Computer, communications and other commercial services; IF = Insurance and financial services; Transp = Transport services; Travel = Travel services.
Source: World Bank, *World Development Indicators* online.

ii. Financial flows

Exports finance roughly 2/3 of imports in the least-developed countries, by comparison with 95 percent in other developing countries. While in the 1980s and 1990s the difference was mainly accounted for by higher net transfers, net capital inflows have recently acquired greater importance. In Table 4 we use the current account deficit after grants to approximate total net capital inflows: by 2004/05, capital inflows and net transfers contributed in roughly equal proportions to the financing of imports, each paying for nearly 15 percent more of the import bill in LDCs than in other developing countries.

Table 4: Financing of imports

Period and country group	n	Cross-country median ratio to imports of goods and non-factor services (percent)			
		Exports	**Net Factor Income**	**Net Current Transfers**	**Current Account Deficit**
	(1)	*(2)*	*(3)*	*(4)*	*(5)*
1984/85					
LDCs	26	62.9	-7.7	23.6	11.9
Other Developing	67	89.5	-9.0	4.4	9.4
1994/95					
LDCs	26	58.6	-4.8	23.6	14.1
Other Developing	67	93.4	-7.6	4.4	8.0
2004/05					
LDCs	26	67.2	-4.9	19.8	15.3
Other Developing	67	95.1	-7.3	5.6	2.5

Notes: The table shows within-group cross-country medians of individual-country ratios of 2-year averages of the column variable to the 2-year average of imports of goods and non-factor services. The table includes all countries with a full set of observations on all variables. If we used means rather than medians, the rows would sum to 100 percent, given the current account identity. All annual US$ flows are first deflated by the USA GDP deflator, before taking time averages.

Source: All variables in US $ from World Bank, *WDI online*; USA GDP deflator, from IMF *IFS online*.

Table 5 looks at particular sources of foreign exchange, including aid, FDI, and remittances. Not surprisingly, concessional official finance remains extremely important for the LDCs. It is roughly the same magnitude as exports among these countries, while it has shrunk to nearly zero (at the median) among other developing countries. Substantial changes nonetheless appear to be underway in the composition of foreign exchange inflows into LDCs with available data. External debt stocks remain large relative to exports in many cases, but they are now well below their values in the mid-1980s, the joint effect of recent export growth and the official debt relief accomplished starting in the mid-1990s. Debt servicing now takes roughly 10 percent of exports at the median, by comparison with over 30 percent in the mid-1980s, with most of the improvement again occurring after 1994/95. Some categories of private inflow, moreover, are rising considerably faster than exports; this is notably true of both worker remittances and FDI inflows, each of which now equals more than 10 percent of exports, a slightly higher ratio than in other developing countries.

Table 5: Aid, remittances, FDI inflows, and external debt

Period and country group	n	Median ratio to merchandise exports (percent)				
		Aid	Worker remit-tances	FDI inflows	Total debt service	External debt
	(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*
1984/85						
LDCs	20	104.8	1.1	0.8	32.4	510.0
Other Developing	41	14.2	0.1	2.1	40.2	333.0
Total	61	32.0	0.1	1.6	37.3	394.0
1994/95						
LDCs	20	145.5	2.2	4.8	25.2	806.0
Other Developing	41	7.0	5.2	8.8	32.9	309.2
Total	61	19.2	4.3	7.7	31.7	391.7
2004/05						
LDCs	20	89.0	11.7	10.3	10.5	377.6
Other Developing	41	2.9	9.1	9.9	21.2	191.9
Total	61	9.3	9.9	9.9	16.9	230.5

Notes: The underlying observations are ratios of 2-year averages of the variables in the columns to the corresponding 2-year average of merchandise exports. The table includes all countries with a full set of observations for all variables. All current US$ variables are first deflated by the USA GDP deflator before taking time averages.

Source: All variables in US $ from World Bank, *WDI online*; USA GDP deflator, from IMF *IFS online*.

Regional generalizations are subject to selection bias, particularly among LDCs where missing data may indicate state breakdown, war, or other dysfunctional links with the global economy. But it is clear from Tables 1-5 that many LDCs have engaged more successfully in global markets since the mid-1990s than over previous decades.

C. Market Access for LDC Exports

i. Preferences in developed country markets

Exports from developing countries have historically received unilateral tariff preferences in industrial-country markets via the Generalized System of Preferences (GSP, instituted in 1968), the EU's Lomé Convention (1975), and other similar arrangements. Preferences increase the prices paid for existing exports, thereby generating a resource transfer that in some cases rivals the magnitude of foreign aid, as in the case of sugar preferences received by Mauritius under the Lomé Convention (Kennan and Stevens 1998). Unlike fixed transfers, however, preferences may also serve as an export-promotion device, a function that is central to their developmental appeal.

Apart from import-competing agriculture and textiles and apparel – sectors that until the Uruguay Round were largely exempt from multilateral trade liberalization – preference margins have declined gradually over time due to global tariff reductions. Margins have proved more durable in textiles and apparel, where until 2005 they were maintained through a system of quotas on established developing-country exporters as well as relatively high import duties, as discussed in more detail in section 8. In agriculture, non-tariff measures continue to generate high and escalated rates of protection in certain sectors, undermining LDC prospects for export diversification into these high-value areas.

Since the late 1990s, the industrial countries have sought to broaden the preferences available to low-income developed countries through initiatives like the EU's Everything But Arms (EBA, 2001) and the USA's Africa Growth and Opportunity Act (AGOA, 2000). Rules of origin are now plausibly viewed as playing a decisive role in the limiting the effectiveness of preferences on manufactured exports, particularly for small, low-income countries (UNCTAD 2003, Hinkle and Newfarmer 2006). In agriculture, the preferences granted to LDCs still fail to cover all items of export interest to these countries, as the 'sensitivity' of a given product determines its inclusion or exclusion in the scheme of preferences; beef, sugar and banana exports to the EU, for example, continue to receive special treatment under EBA.

The impact of preferences on exports depends on the structural and policy determinants of export supply response and on the design of the preferences. Collier and Venables (2007) argue that supply elasticities are larger in manufacturing than in land-constrained traditional agriculture, and that even temporary preferences can induce a permanent increase in manufactured exports given the prevalence of agglomeration effects.

Preferences are mainly relevant to a small number of labor-intensive manufactured goods and agricultural products facing relatively high import duties. Our case studies suggest, however, that the avenues for export expansion by LDCs include horticulture, fish, and the traditional sector where tariffs in developed countries are low and preferences are consequently of little significance.

In addition, the EU is moving to replace its non-reciprocal preferential agreements under the 2000 Cotonou Agreement (the successor to the Lomé Convention) with Economic Partnership Agreements (EPAs). EPAs are based on reciprocal liberalization and as such require significant tariff reductions in participating LDCs. The impetus for negotiating EPAs between the EU and the ACP (African, Caribbean and Pacific) countries arose out a challenge by non-ACP countries at the WTO against the discriminatory nature of the preferences granted to ACP countries; among others.

The EPAs could involve significant costs to ACP countries from forgone tariff revenue, reduced intra-regional trade, and increased pressure on local industry, that more than outweigh any benefits of greater access to the EU market (Hinkle and Newfarmer 2006), given the generally low EU MFN tariff barriers. In negotiating EPAs, therefore, the LDCs should seek to ensure that these agreements a) promote their development objectives, particularly through strengthening their productive and supply capacities; b) contribute to consolidating regional integration processes; and c) enhance inward FDI flows. Flexible provisions and long transition periods may be required to minimize the costs and potentially adverse impacts of adjustment and reform in LDCs.

ii. Protection and subsidies in developed countries

Trade barriers and domestic supports to agricultural commodities such as cotton, sugar, and groundnuts depress the terms of trade for LDCs with comparative advantage in these commodities. Cotton has been the most frequently-cited example of the adverse effects of developed country subsidies, as discussed in the case study in section 6. Industrial country commitments to reduce these impediments to LDC exports of agricultural products in the Doha Round have yet to be honored and major progress seems unlikely given the special interests in major trading partners, especially in developed countries. Moreover, while it is true that net exporters of cotton and other affected products are hurt by lower world prices, the case studies indicate that the constraints on LDC export growth are primarily domestic. Also, most agricultural primary commodities in which LDCs have comparative advantage – such as coffee, cocoa, and bananas – are not produced in developed countries, and market access is relatively open for unprocessed exports of these agricultural commodities. The same is true for minerals.

iii. Standards and technical regulations in developed countries

As the case studies of horticulture, groundnuts, and fish below discuss in some detail, satisfying developed country health and safety norms has become a major challenge for LDC exporters. EU requirements are particularly strict for food safety. Compliance is difficult and costly, requiring investment in laboratories, safety and management systems, and technical expertise. Developed countries are often accused of disguised protectionism and some of these allegations appear convincing, but sanitary standards are driven by consumer demands and LDCs cannot expect to be exempt from meeting them (Ignacio 2007). The case studies show that LDCs can upgrade standards and export successfully, with the help of donors and foreign investment.

iv. Regional trading arrangements

Regional trading groups are proliferating in the developing world, especially in Africa. There are some 30 regional groups in Africa, and on average each of the 53 countries on the continent is a member of 4 (typically overlapping) groups. Yet official intra-African trade flows remain very low. Excluding South Africa, intra-African trade accounts for less than 10 percent of total African exports and imports (Yang and Gupta 2005). This low level of trade within Africa reflects two inter-related factors: 1) the poor condition of transportation links between countries, including the costs associated with multiple checkpoints and onerous regulations, and 2) the prevalence of smuggling, which often produces a dramatic difference between actual intra-regional trade and the official statistics.

A drawback of regional trade blocks is that they create a "spaghetti bowl" of rules of origin and discriminatory trade taxes, leading to possible trade diversion.

Even with limited intra-regional trade, regional groups can be beneficial as a sort of support group for reform but for many regional groups, such as the Economic Community of West African States (ECOWAS) in West Africa, progress has been minimal in harmonizing policies. The West African Economic and Monetary Union (WAEMU) has been much more successful in this regard but is problematic from a geographical point of view, as its members are not contiguous, with neighboring Anglophone countries not included. While properly crafted and sequenced integration process could beneficial for trade creation and expansion,, as the findings of the national and sector-specific case studies indicate, regional integration at present has limited scope for expanding intra-African trade.

v. Aid-for-trade and the Integrated Framework

Donors can assist LDCs through trade-related technical assistance. Examples of donor support for production and marketing of exports are provided in the case studies. The Integrated Framework (IF) is an important initiative of six international organizations concerned with international trade and development (the World Bank, the IMF, the World Trade Organization (WTO), the United Nations Conference on Trade and Development (UNCTAD), the United Nations Development Program (UNDP) and the International Trade Center (ITC)) to collaborate in assisting LDCs to integrate into the world economy. The initial phase of the IF involves the preparation of a comprehensive analysis and set of policy recommendations for each participating LDC's international trade, called a Diagnostic Trade Integration Study (DTIS). The DTIS identifies areas for technical assistance and other forms of donor support for policy and institutional reforms.[*]

The outcome of the much-awaited Doha Round of WTO negotiations should include significant 'aid for trade' for LDCs. There is a broad consensus that LDCs need technical assistance to build the capacity to formulate locally-owned trade policies, to participate more effectively in trade negotiations, and to implement trade agreements. Where implementation involves large adjustment costs, donors can provide compensatory assistance. Finally and most critically, donors can help address the production and supply constraints that limit export diversification and the contribution of trade to poverty reduction. This means, along with the production and marketing assistance featured in some of our case studies, assistance for trade-related infrastructure. Regional projects (for example in telecommunications, transport, and the development of energy and water resources) deserve special attention, as they have great potential for

[*] The IF's governing bodies recently adopted an 'Enhanced IF'in an effort to spur implementation of the recommendations emerging from the DTIS process. Enhancements focus on expanding financial support from donors and deepening the integration of trade into national development strategies.

generating economies of scale and stimulating regional trade. The latter is of particular interest to landlocked LDCs.

vi. WTO rules and export promotion in LDCs

It is sometimes argued that LDCs are handicapped by WTO rules on export subsidies and import barriers, preventing them from following the infant-industry protection strategies employed successfully by the Asian tigers (Lall 2002, Westphal 2002). While it is true that the WTO prohibits export subsidies, LDCs are exempted from this ban, and in any case many other forms of assistance to exporters remain permissible, including subsidies other than those directly targeting exports. Export-processing zones, for example, are not challenged by the WTO. Our case studies illustrate a wide range of export-promotion policies that LDCs can and have pursued.

In summary, barriers to developed country markets are a significant problem for some LDCs exporters, but are rarely insuperable. Conversely, preferences from developed country and regional trading arrangements are helpful but limited. Instead, domestic supply constraints and policies are usually much more important, as discussed in the next section and illustrated in the cases.

D. The Domestic Institutional and Policy Environment

In a globalized world, firms can choose where to locate investment. Both economic theory and empirical evidence indicate that internationally-mobile factors of production, particularly foreign direct investment (FDI), looks for the most favorable locations for production (Golub, Kierzkowski and Jones 2007) and (UNCTAD world Investment Report: 2005. Those countries with favorable business climates can attract FDI and other mobile inputs, and participate in international production networks. More generally, countries in which doing business is difficult cannot compete in transactions-intensive industries such as manufacturing and horticulture (Collier 1997, Lyakurwa 2007). International competitiveness and the investment climate are increasingly synonymous, as evidenced by the prominence of country rankings[*].

LDCs have made progress in eliminating the most severe distortions arising from fiscal deficits, exchange rate overvaluation and high and variable import barriers. It is increasingly recognized, however, that much more is involved in creating a favorable business climate, with the government having a crucial role in providing public goods and overcoming market failures.

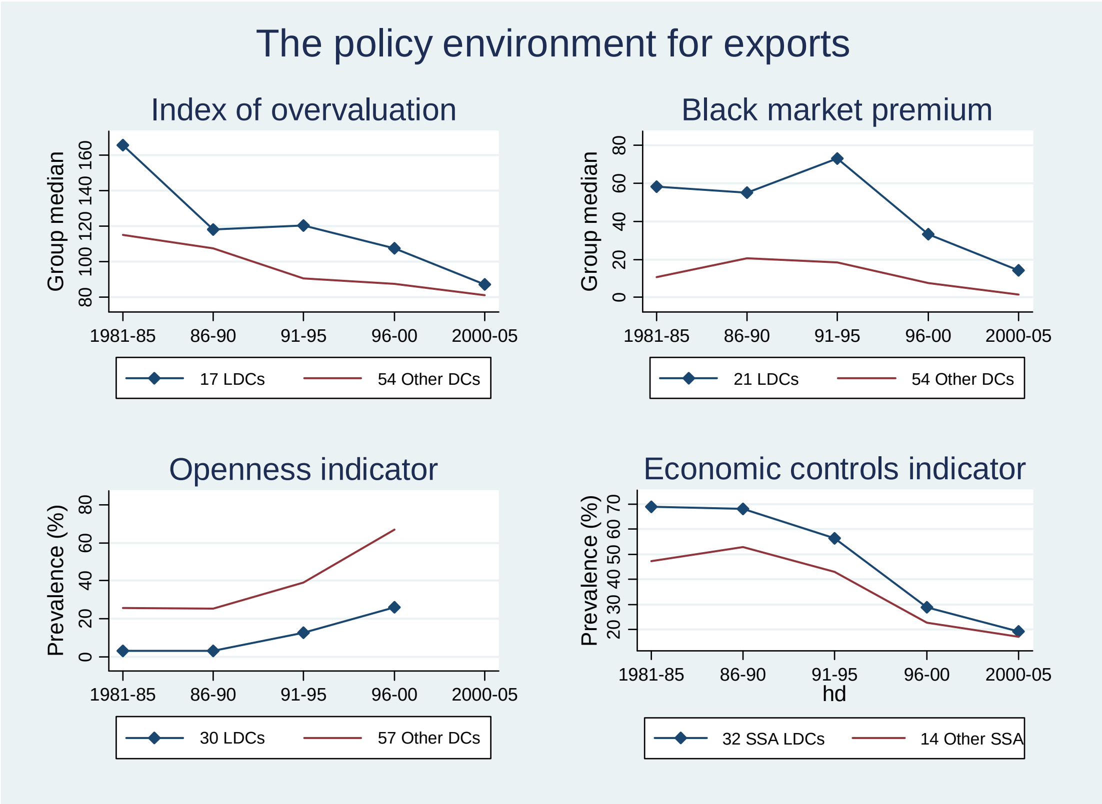
i. Market-based reforms

The domestic environment for LDC exporters has changed dramatically since the 1980s. Market-based reforms undertaken during the 1980s and early 1990s scaled back government intervention in markets and removed the most egregious forms of anti-export bias. These achievements were strengthened in the 1990s, in a number of cases, by membership in the WTO, accession to Article VIII status in the IMF, and a reconstitution of key domestic agencies of restraint, including central banks.

Figure 1 below shows four broad measures of the changing policy environment for exports, in each case comparing LDCs as a group with other developing countries. The first panel tracks bilateral real exchange rates against the U.S. dollar, with each country's real exchange rate series rebased to reflect the degree of overvaluation calculated for the 1976-85 period by Dollar (1992). LDC currencies were markedly more overvalued at official exchange rates in the early 1980s, but their (median) adjustment was substantial in the late 1980s, and real depreciation continued in the late 1990s and early 2000s.

[*] [*] Such as the World Bank's Doing Business Indicators, the World Economic Forum's Competitiveness Indexes, and the Heritage Foundation's Index of Economic Freedom, UN-ECA Governance Report and the report of International Transparency Commission.

Figure 1



Notes: The underlying country observations are non-overlapping 5-year averages. The figures include all countries with at least 2 annual observations in each 5-year period, so that in each panel the set of countries in each group is constant over time. The *index of overvaluation* is constructed by calculating a real bilateral real exchange rate versus the US dollar (increase = appreciation) and rebasing it so that its average level for the 1976-85 period corresponds to the degree of overvaluation reported by David Dollar (1992) for that period; a value of 100 indicates no overvaluation. The figure reports group medians of the underlying country averages. The *black market premium* is the percentage excess of the black market exchange rate over the official rate; in tracking this variable we exclude all countries identified by Frankel and Rose (1992) as members of currency unions in 1980. The figure reports group medians of country averages. The *openness indicator* is the openness dummy variable constructed by Sachs and Warner (1995) and extended to 1998 by Easterly, Levine and Roodman AER (2004); it classifies a country as closed (= 0) if it has government monopoly marketing boards for exports, a socialist government, an black market premium above a threshold, average tariffs above a threshold, or quota coverage above a threshold; otherwise the country is open (= 1). The figure reports the overall 'prevalence' of openness, which is the proportion of country-years in the group that were classified as open during the period. The *economic controls indicator* is based on the dummy variable for the 'excessive regulatory controls' syndrome reported in Collier and O'Connell (2007) and discussed in detail in Bates (2007). This variable is based on judgmental assessments and is designed to capture heavy government controls on private economic activity in domestic and international trade, foreign exchange markets, and financial markets. The overall 'prevalence' of controls in each period is the proportion of country-years displaying the excessive controls syndrome.

The second panel of the figure indicates black market premia for countries that operated national currencies at the outset of the sample.[*] The premium reflects a wide variety of forces, but a persistently

[*] We exclude countries that were members of currency unions in 1980. The black market premium is a poor measure of national policy choices for these countries, because it tends to reflect the exchange controls and policy decisions of the dominant member, which is often a hard-currency country with a low and stable premium (as in the case of the CFA zone members whose currency is virtually freely convertible into ECU and previously the French Franc). Accession to a currency union, by contrast, may for the same reason indicate a desire for exchange rate unification.

high premium reflects the operation of tight exchange controls on the current account and has historically proven very damaging to officially recorded exports (Kiguel, Lizondo and O'Connell 1995). Very high premia were in many cases reduced among the LDCs during the late 1980s and early 1990s, but we abstract from outliers by focusing on group medians. The figure suggests that by the second half of the 1990s a substantial share of LDCs had approached full convertibility for current account purposes.

The third and fourth panels show broader measures of the environment for private sector exports. Panel 3 shows the celebrated 'openness' indicator developed by Sachs and Warner (1995), as updated through 1998 by Easterly, Levine and Roodman (2004). Virtually no LDCs were classified as open in the 1980s, but the proportion rose to more than 20 percent over the course of the 1990s. Panel 4 suggests that this trend was deepened by 2005, at least among African LDCs; it shows a qualitative measure of 'excessive regulatory controls' in African countries, based on judgmental assessments by a team of experts. Collier and O'Connell (2007) discuss this variable in detail and show that among coastal and labor-abundant African economies, those that steered clear of excessive controls for the longest period after 1980 experienced the greatest degree of diversification away from primary commodity exports and into manufacturing and services.

Each of these measures of the policy environment for exports has shortcomings, but in concert they suggest that for many LDCs, domestic trade and macroeconomic policies no longer constitute the decisive barriers to export performance that they did in the 1980s. The institutionalization of these improvements continues to be critical, as reversals can once again place favorable exporting opportunities out of reach. But progress in removing other barriers is now likely to have a considerably stronger impact on export growth and diversification than in the 1980s and early 1990s.

ii. Infrastructure

Reliable and reasonably-priced infrastructure is one of the main requirements for export diversification and growth.[*] Infrastructure includes transport (land, air, and maritime), electricity and water, and telecommunications. Poor transport and communications systems in many LDCs, especially in Africa, raise transactions costs and impede international trade (Mbekeani 2007, Bachetta 2007). Land-locked countries face particularly high transport costs. Lack of investment and inadequate maintenance of facilities as well as poor administration and extortion characterize transport systems in almost all countries in Africa. Transit times at African ports are often far longer than in other developing countries. High costs and low reliability of electricity provision, especially power outages, are also endemic in Africa, and have been identified as the single most important constraint on growth, with generators representing the bulk of investment for small manufacturing firms (Mbeakeani 2007, Eifert, Gelb and Ramachandran 2005).

We therefore exclude from the figure countries that were members of currency unions in 1980, but include countries like Mali that subsequently joined a union.

[*] See Yeaple and Golub (2007) and Golub, Jones, and Kierzkowski (2007) for theory and evidence on the role of infrastructure in affecting productivity, exports and FDI.

Table 6. Indicators of infrastructure quality, selected LDCs and comparison countries

	Number of electrical outages (days)	Time for imports (Days)	Telephone subscribers (per 1000)	Telephone average cost of call to US (US$ per three minutes)
LDCs				
Angola	87.3	74	75	3.23
Bangladesh	..	35	71	2.02
Benin	77.3	35	98	4.80
Burkina Faso	9.6	69	51	1.14
Burundi	137.0	80	..	2.45
Cambodia	4.9	43	..	..
Lesotho	19.1	46	163	3.28
Madagascar	78.0	48	31	0.59
Senegal	26.1	22	171	1.02
Tanzania	60.6	30	..	3.17
Uganda	70.8	42	56	..
Zambia	..	60	89	1.41
Comparison group				
Germany	0.2	6	1628	0.43
Chile	3.7	24	859	2.30
China	4.3	24	570	2.90
India	67.2	43	128	1.19
Malaysia	..	22	943	0.71
Mauritius	6.0	16	862	1.67
Thailand	1.1	22	..	0.67

Source: World Bank World Developed Indictors, World Bank Investment Climate Surveys, International Finance Corporation Doing Business Indicators.

Table 6 presents some indicators of infrastructure quality for selected LDCs and comparison countries. In developed countries such as Germany power outages are minimal, a telephone call to the US costs about 50 cents for 3 minutes, and import procedures require a few days. In Sub-Saharan Africa, in contrast, power outages are common, the cost of a 3 minute call to the US is often over $3.00, and the time to complete import formalities can be 1-2 months or more. Mauritius is an exception to this dismal situation in Africa. It is no coincidence that the latter is among the few successful exporters of manufactures on the continent. Likewise, successful exporters such as China, Malaysia, Thailand and Chile generally have much favorable infrastructure quality than most LDCs.

Many LDCs have moved to privatize infrastructure services, but success has been mixed. Given the natural monopoly and public good features of infrastructure, the government retains an important oversight role even when infrastructure services are privatized, and this role has proven difficult for most LDCs to carry out effectively.

Where the scope for private provision is limited, donors may have a critical role to play in infrastructure provision. Taking up this role will require not just a continued increase in aid, but also a shift in donor priorities. Between 1992-94 and 2002-04, the share of ODA devoted to economic infrastructure and productive sectors declined from 48 percent of commitments to only 24 percent.(UNCTAD 2004)., *iii. The institutional environment*

There is an increasing consensus in the literature on economic development that the quality of institutions and policies are decisive in determining whether countries can benefit from globalization.[*] The institutional environment encompasses macroeconomic stability and openness to trade, as well as the enabling environment for markets, consisting notably of the judiciary and legal system, the financial system, taxation, labor relations, investment procedures, land tenure, and customs administration. Weak property rights, red tape and corruption remain pervasive. We highlight some of the main issues briefly.

Legal and judiciary systems. Inappropriate legal systems and poorly-functioning judiciaries lead to weak property rights and contract enforcement in most LDCs. Court cases advance slowly if at all. There is a shortage of properly trained lawyers and judges, and they are poorly paid. Land tenure rights are often ill-defined. In some countries, labor laws embody European-style protections for workers that are inappropriate in poor countries and contribute to the growing informal sector.

The financial system. In many LDCs, finance is characterized by an oligopolistic banking system that fails to provide any significant long-term credit to the local private sector despite a liquid money market; high real interest rates to borrowers; and large spreads between deposit and loan rates. Micro-credit institutions provide loans at a very small scale, but local medium- and small-scale enterprises are largely shut out from access to reasonably-priced credit. The lack of secure property rights contributes to banks' reticence to lend.

Taxation. Tax rates are often high and complex, with the tax burden falling disproportionately on a small formal sector. Many LDCs remain dependent on trade taxes for a large proportion of revenue.

Customs and investment procedures. Administrative procedures are typically very complex and cumbersome, providing opportunities for rent-seeking but dissuading investment. Ineffective trade facilitation procedures, mainly customs, are a more significant source of anti-export bias in many countries than import and export taxes (Clarke 2005).

D. Exports and investment promotion

Coordination failures and information externalities justify government assistance to potential exporters and investors (Hausmann and Rodrik 2006), but the question of selective industrial policies remains highly controversial (Bachetta 2007, Pack and Saggi 2006). Can governments identify areas of potential comparative advantage and effectively implement industrial policies?

Most countries have trade support institutions. These services include trade information; assistance in product adaptation and export marketing; assistance in the field of standards, quality management, packaging and labeling; a national trade representation service abroad; participation in international fairs and exhibitions; training; legal assistance; and assistance in obtaining export financing. These services are usually offered by a mix of public and private institutions or consultancy firms, some free of charge or at low cost and some at actual cost. In LDCs seeking export diversification, governments tend to offer these services through specialized public trade support institutions.

In practice, however, trade support institutions are almost always ineffective in LDCs (Hogan, Keesing, and Singer 1991). In many countries, several poorly-funded agencies with unclear and overlapping mandates, both public and private, fail to provide useful services to exporters. A recent study suggests that export promotion can be successful when support agencies are adequately funded; have a large private representation in management; and are consolidated into a single institution rather than a proliferation of small agencies (Lederman, Olarrreaga, Payton 2007). In LDCs, these conditions are usually not satisfied.

[*] See for example, Acemoglu, Johnson and Robinson (2004), Dollar and Kraay (2003), and Hall and Jones (1999).

Given these institutional weaknesses, the scope for industrial policies in LDCs is limited. Most LDC industrial policies have been failures. Infant-industry protection is not viable in LDCs with small markets and limited industrial bases. Nevertheless, our cases show that targeted sector-based policies, with technical and financial assistance from donors, can successfully attract foreign investment. The most important role for governments, however, is to provide functional basic infrastructure and public services.

E Traditional Primary Product Exports[*]

Many LDCs' exports, especially in Africa, are concentrated in a few "traditional" primary mining or agricultural commodities such as oil, copper, coffee, cocoa and cotton. A long-standing concern is that specialization in such products is unfavorable for development due to volatile and adverse terms of trade (Ng and Yeats 2002), the 'resource curse' and the absence of dynamic learning effects. While the case for diversification remains strong, we find that there is also considerable scope for increasing gains from traditional exports, especially in agriculture. We make three main points:

1. The resource curse is a daunting problem, but some countries have successfully deployed resource rents for development and poverty reduction.
2. Traditional products can be a source of dynamic gains through technological upgrading.
3. Relative to the US price index for manufactured goods (as opposed to the GDP deflator) primary product prices are highly volatile but do not show a clear downward trend. This is obviously the case for oil, but it is also true for a number of other commodities, especially other minerals whose prices have recently jumped due to booming demand from China (Figures 2a and 2b).

i. Oil and mining[†]

The oil and mining sectors have long been the dominant export in several LDCs such as Angola and Zambia. Within the last decade, however, these sectors have become a leading source of FDI and growth for new entrants like Equatorial Guinea, Sudan, and Chad. While this impetus has been heightened by sharp increases in world oil prices, it mainly reflects longer-term forces that will continue to deepen the comparative advantage of LDCs in these sectors, including the integration of labor-abundant India and China into the world economy and the cumulative impact of outward-oriented reforms on export diversification among middle-income countries. These price increases can be highly beneficial to exporters if they can manage the revenues carefully.

Figure 2a

[*] Our analysis in this and the following sections is based on detailed case studies of particular sectors and countries. These main findings from the cases are summarized here; more details are provided in the Appendix to this paper, which is available separately. A large number of LDCs but not all of them are included in the cases. Much of the information on these cases comes from recently-completed DTISs (Diagnostic Trade Integration Studies) carried out for the Integrated Framework.

[†] Draws on country case studies of Botswana, Indonesia, Zambia, Chad, and Timor-Leste.

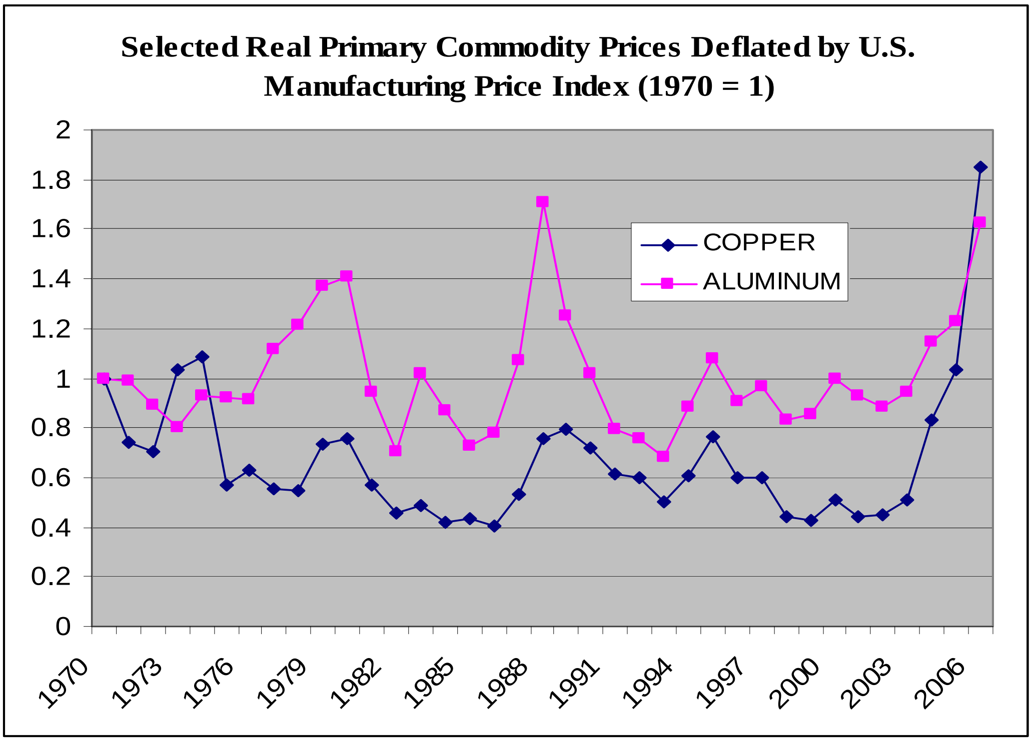
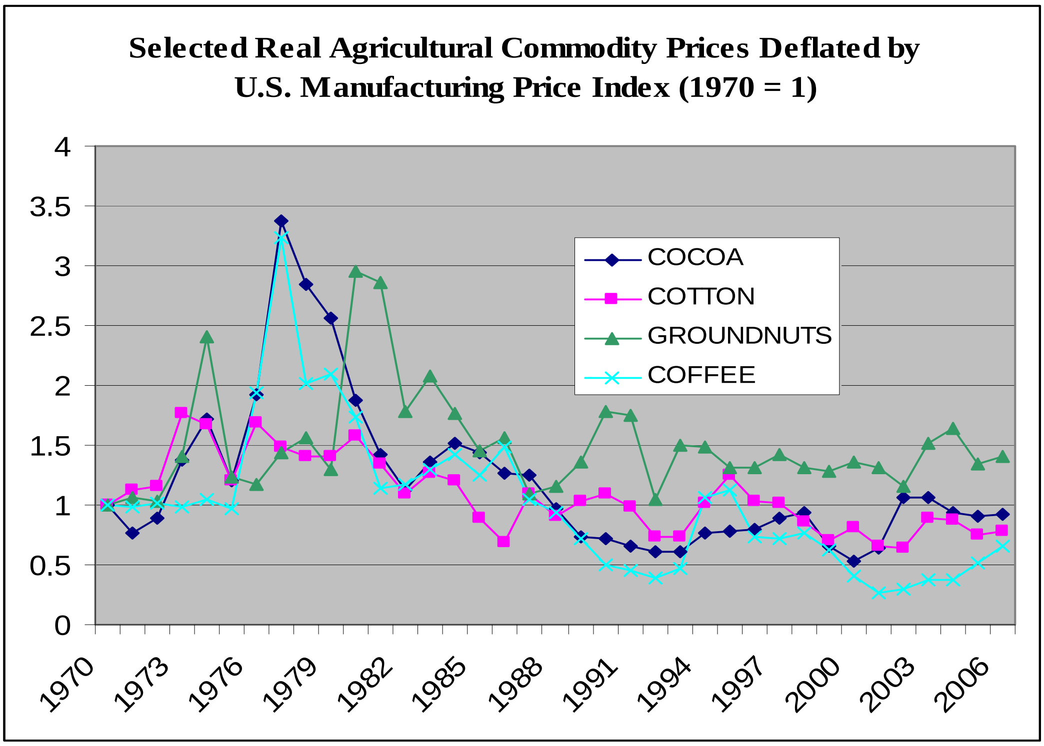


Figure 2b



The experiences of Botswana and Indonesia suggest that well-managed oil and mineral exports can be a springboard to growth and human development. But as many studies including Sachs and Warner

(2001) and Collier (2007) have shown, natural resource booms have more often than not proven detrimental. The challenges associated with the 'natural resource curse' are likely to be sharpest among the least-developed countries, and much sharper for the extractive industries than for agricultural commodities. The 2004 Least Developed Countries Report looked into the relationship between civil conflict, international trade and poverty with focus on countries with natural resources. In its 2005 Economic Development in Africa Report: Rethinking the Role of Foreign Direct Investment, UNCTAD has critically examined prevailing polices and strategies related to FDI in extractive industries.

The resource curse stems from two features of the extractive industries. First, a large portion of the export price constitutes an economic rent to the owners of oil- or mineral-bearing land. These rents scale up a country's import capacity and fiscal revenue base well beyond what is required to service the capital investment required for their extraction. But they can also promote a culture of opportunism and patronage. Where public institutions are weak, productive resources may be diverted into rent-seeking and possibly armed conflict; easy budgetary resources may undermine public scrutiny and institutional development; and political pressures may generate over-spending and a low return on public investment.

The second key feature of extractive activity is that it typically has few direct linkages to domestic labor and input markets. Domestic technological and demand/supply spillovers associated with resource extraction tend to be small, and its direct impact on income distribution is often adverse. The contribution of resource rents to development is therefore, at best, indirect: large and volatile rental incomes must be converted, through the government budget, into investments that increase labor productivity in the non-mineral economy over time. Even with strong institutions, the Dutch disease effects of mineral exports divert resources from the non-mineral export sectors where productivity externalities and other positive spillovers are generally thought to be larger.

Countries that have developed successfully from a mineral base have done so by avoiding armed conflict, maintaining macroeconomic stability, investing heavily in human development, and undertaking explicit efforts to promote important sectors including agriculture and non-mineral exports (Roemer 1997, Westphal 2002, Collier and Hoeffler 2002). Where growth opportunities in the non-mineral sector were modest, as in Botswana, the government avoided over-spending and built an infrastructure platform for future diversification. Where opportunities were favorable, as in Indonesia, policy focused on enhancing existing comparative advantage and attracting investment into labor-intensive sectors including non-traditional exports. In both countries, fiscal institutions were designed to avoid over-spending.

The importance of institutional quality suggests that among LDCs, extractive-industry exporters should focus on buttressing existing domestic agencies of restraint while supporting institutional innovations to increase absorptive capacity. These considerations are behind the adoption of Norwegian-style stabilization funds by São Tomé and Príncipe and Timor-Leste. These funds envision spending the annuity value of rents and holding the remainder in a combination of foreign assets and unexploited reserves. Pressures to spend faster and less efficiently will be ferocious, and increasing the public sector's capacity to identify and deliver effective spending programs is among the most urgent priorities for these countries in the short run. Chad's revenue-management plan already envisions spending considerably more than the annuity value of rents in the short run, under a World Bank agreement that directs the bulk of spending into the social sectors and transfers oversight to a non-governmental organization. The recent abrogation of this agreement by President Déby illustrates the difficulty of applying principles of aid conditionality to sovereign resources, but it does not invalidate the need for a suitable combination of spending constraints and increases in absorptive capacity.

Successful deployment of mineral rents requires a combination of fiscal prudence with public spending targeted at poverty reduction and export diversification. Success depends on a public expenditure process that is technically capable, reasonably business-friendly, and insulated from opportunistic political pressures. Technical capability is probably the easiest of these, since donor countries and multilateral institutions can help overcome domestic supply constraints. Businessfriendliness is more difficult but it has been enhanced by over a decade of market-oriented reforms and by more recent efforts to improve public service delivery. Insulation from political pressure is probably the hardest; it requires internal security and far-sighted domestic leadership, buttressed by internal and external agencies of restraint. Economic reforms have enhanced the roles of internal agencies of restraint like central banks, and have begun to improve the budget process in many least developed countries. Democratic reforms have probably had a more complicated impact, enhancing transparency on the one hand but opening room for populism on the other.

Development partners have relatively little direct leverage over countries receiving large mineral rents, but they can exert a powerful indirect influence by addressing some of the mechanisms through which mineral rents subvert governance and institutional development in the exporting countries. Key initiatives include the Extractive Industries Transparency Initiative and banking sector regulations that undermine safe havens for corrupt money.

In addition to the managing resource rents, productivity in extraction, has often been low in LDCs due to excessive state intervention. In Zambia, for example, copper mining productivity improved when the mines were privatized. Although the scope for employment creation and learning is less in minerals than in agriculture, manufacturing, and services, even here LDCs have much to gain from fostering an environment conducive to foreign investment.

ii. Traditional agricultural exports

The analysis of key issues in traditional agricultural products is complemeneted by the case studies of three products: cotton, coffee, and groundnuts. For each of these three products, we analyzed the experiences of several LDC exporters.

Cotton: Cotton production has grown strongly in Africa in the last two decades, especially in the francophone countries; it is the dominant export commodity for Mali, Benin, Burkina Faso and Chad, where it accounts for 30-70 percent of total merchandise exports, and is the second largest export crop after coffee in Tanzania and Uganda (Baffes, 2004ab). Cotton has become the main source of cash income for large numbers of poor smallholders, farm laborers and workers in ancillary activities in these countries. Despite rudimentary technology, costs of production are low in Africa, and African countries' share of world exports rose from 7 percent in 1980-82 to 17 percent in 2000-2003, with the francophone countries' alone going from 4 percent to 13 percent (Goreux and Macrae 2003).

The cotton sectors in LDCs face severe global and local challenges. At the global level, world prices have exhibited high volatility and a long-term decline since the early 1970s, although the downward trend has diminished since the early 1980s. The declining prices are largely explained by the reduction in costs of production, notably the adoption of genetically modified (GM) cotton varieties by major producers, slow demand growth, and strong competition from chemical fibers (Baffes, 2004a). Large cotton subsidies in the US, EU and China also notoriously contribute to downward pressure on world prices and became a major point of contention during the Doha Round of trade negotiations. In 2002, total support to the cotton sector in major producing countries exceeded a quarter of the value of global production (Baffes, 2004b).

At the domestic level, state-owned marketing boards were the norm in Africa until the 1990s. In some respects, this government-controlled system worked quite well in providing inputs and credit to farmers while ensuring repayment (Goreux and Macrae 2003). Production expanded sharply in a number of countries, but there were significant weaknesses too. Prices paid to farmers were well below world prices, and corruption and inefficiency often thrived in the absence of competition. Production increased due to increased acreage but productivity stagnated.

In recognition of the inefficiencies of these marketing boards and in response to pressure from the IMF and World Bank, many cotton producing-LDCs privatized and liberalized their cotton sectors to varying degrees in the 1990s. The results of the reforms have been mixed. Benin and Tanzania, for example, pursued rather ambitious reforms. In Benin, a monopoly marketing board, the SONAPRA, had controlled all stages of the production process: importation and distribution of seeds and inputs, provision of credit and other services to farmers. In some respects the reforms initially worked well, with entry of private ginners and input suppliers. But contract enforcement lagged, and opportunistic behavior spread as firms with political connections were not sanctioned for violating their obligations, resulting in the near breakdown of the system. In Tanzania, the share of prices received by producers rose and delays in payments dropped sharply following reforms, but the supply response was limited. The input distribution system and credit recovery nearly collapsed as contract enforcement proved weak and opportunistic behavior spread, as in Benin. Use of fertilizer declined. As in Benin, excess capacity in ginning emerged and the quality of inputs and cotton may have declined.

Reforms were more limited but also more successful in Burkina Faso. Two private firms were permitted to enter, and along with the incumbent parastatal SOFITEX, were granted a regional monopoly for 8 years, thus greatly limiting competition. In addition, producer prices remain administered and delinked from the world market. Since the liberalization, the ginners have incurred losses due to the requirement of maintaining stable prices to producers despite the decline of world prices exacerbated by the appreciation of the CFA franc against the U.S. dollar. Nevertheless, the chaos witnessed in Benin has not been replicated in Burkina, both because the institutions appear to be stronger and less politicized in Burkina and because the reforms were more cautious. On the other hand, the reforms in Burkina did little to increase competition.

Our case studies illustrate that African countries have demonstrated a comparative advantage in cotton production even in the face of an adverse external environment, notably declining world prices. Although the LDCs would greatly benefit from removal of cotton subsidies in the US and EU, the prospects for major progress are slim (Baffes, 2004a). Moreover, although elimination of subsidies would increase the world price by 10 to 15 percent, it would be one-time gain. These observations imply that LDCs should focus their primary efforts on alleviating domestic supply-side constraints

The integrated state-controlled system was evidently flawed, but reforms have had mixed success. Opening the market has often entailed opportunistic behavior rather than competition. Provision of public goods has suffered. Further liberalization of pricing and greater scope for competitive bidding must be combined with attention to institutions that enforce rules and sanction contract violations. The travails of cotton-sector reforms vividly illustrate the tremendous importance of the role of government in establishing an institutional structure and providing public goods. How to obtain the benefits of competition while limiting opportunistic behavior remains a largely unsolved challenge requiring more study and experimentation.

Coffee: Coffee ranks second in value to crude oil in world primary-commodity trade. Brazil, Colombia and Vietnam account for more than half of global coffee output. African output has stagnated since the early 1970s, while production in Asia and Latin America has increased sharply over time (Lewin *et al.*, 2004). Notwithstanding their low share of global output, a number of LDCs are heavily dependent on coffee as a source of foreign exchange earnings and rural incomes. Coffee accounts for more than half of merchandise exports in Burundi, Rwanda, and Ethiopia, and is the most important agricultural export in Uganda, Tanzania, Sierra Leone, Guinea and Haiti, with smallholders constituting the bulk of production in most of these countries (Baffes *et al.*, 2005; various DTIS). There is a strong correlation between poverty reduction and changes in world coffee prices in a liberalized market (Bussolo *et al.*, 2006).

Low short-run elasticities of supply and demand, weather shocks, and demand fluctuations contribute to high volatility of world coffee prices (Levin *et al.*, 2004; Baffes *et al*, 2005). World coffee prices rose by more than 100 percent in the first half of the 1990s, at a time when many LDCs had begun to liberalize their coffee sectors; prices then fell below the early 1990s levels by 2001, before recovering somewhat through 2006 (Bussolo *et al.*, 2006).

As for other traditional commodity exports, governments of developing countries intervened heavily in the coffee sector, often with monopoly marketing boards. The prices received by producers were generally far below world prices during the 1970s and 1980s (Krivonos, 2004).

During the l990s, many Sub-Saharan African countries began reforming their coffee sectors, as part of broader structural adjustment programs. As in the case of cotton, the success of these reforms was mixed, varying with the implementation process and the capacity of the private sector. Uganda illustrates the ambiguities. The coffee reforms were highly successful initially, with entry and competition among private traders leading to prompt payments to producers and a doubling of the share of producers in export prices, with substantial new investments and dramatic supply response and resulting gains for farmers. Subsequently, however, production declined as world coffee prices fell, and failed to recover as prices rise. The causes of the failure to sustain the initial gains from reforms in Uganda are debated, with some attributing them to external shocks in the form of coffee wilt disease (Baffes 2006).

In Rwanda the coffee industry continued to decline even after liberalization, until the advent of the government's Coffee Strategy and Action Plan, initiated in the late 1990s and supported by USAID. Rwanda has made great progress during the last five years in producing high-quality brands which are now sold worldwide through more than 30 renowned specialty roasters and importers, including Starbucks. With substantial financial, marketing, training and technical assistance from USAID, together with the private sector's response to dramatic price differentials based on quality, 70 new private washing stations were constructed between 2002 and 2006. By 2006, the country was exporting 26,000 tons of coffee, of which about 10 to 15 percent is fully washed (USAID, 2006b). USAID's intervention helped overcome coordination and knowledge-related market failures. The further development and sustainability of the Rwandan coffee miracle remains to be seen, however, when USAID withdraws and if prices drop.

The Rwanda success story illustrates the possible comparative advantage of LDCs in niche coffee markets, such as gourmet, organic, fair trade, and eco-friendly coffee, but this potential is largely undeveloped in many LDCs such as Laos. Donor support played a critical role in Rwanda's coffee success story. The Rwandan experience suggests that liberalization is necessary but not sufficient to jump-start the development of specialty coffee production. Since coffee processing and marketing require sophisticated technical know-how and connections, targeted provision of infrastructure through external assistance and foreign investment are required, facilitated through committed but flexible government policies.

Groundnuts: Groundnuts are or have been a major source of foreign exchange earnings and employment in several African LDCs, notably Senegal, The Gambia and Malawi, and have had a lesser role in several other countries including Sudan, Nigeria and South Africa. World groundnut prices have actually increased in real terms since the early 1970s, and have stayed relatively stable since the early 1980s. Africa's share of world production and exports has declined sharply, however (Beghin, Diop, and Matthey 2006, Diop, Beghin, and Sewadeh 2004). Groundnuts can be marketed in edible form or processed, mainly as oil. The demand for groundnut oil has declined as consumers have shifted to healthier or cheaper substitutes such as soybean and palm oil. Meanwhile, concerns about aflatoxins[*] and pesticide residues have ratcheted up the quality standards in the edibles market, with higher qualities commanding increasing premiums. Groundnuts for pressing into oil fetch lower prices than edibles. That is, edibles are actually more sophisticated and higher value added products than groundnut oil. In this regard, it is disconcerting that the African countries' market share of the world edibles market declined precipitously to 5 percent in 2001 from 17 percent in 1976, while Senegal remains the world's largest producer of groundnut oil (Beghin, Diop, and Matthey 2006). Subsidies and trade barriers in the major

[*] Aflatoxins are a known cancer-causing substance that contaminates groundnuts when handling and storage are slow and the crop is exposed to inappropriate moisture and temperature.

consuming markets are also a problem, but these have eased somewhat and do not explain Africa's declining market share.

Groundnuts are the main cash crop in Senegal and The Gambia. Although their economic significance has receded in both countries, large numbers of smallholders still cultivate groundnuts. Output and exports have declined drastically since the 1970s, however, due the combination of declining rainfall and poor management. In both countries, the national marketing board suffered large losses over time due to politicization, with failure to recoup farm-input credits and subsidies to producers, especially during presidential elections (Gambia DTIS 2007, Golub and Mbaye 2002). Privatizations have been attempted but stalled or failed in both countries. Although heavily involved in marketing, credit and inputs, governments have neglected the provision of extension services and infrastructure. Also, due to the disorganization of marketing, farmers often sell their produce on parallel markets. In Senegal especially, groundnut oil production has been subsidized and protected, while edibles have been neglected, reflecting powerful domestic interests in the processing sector.

With rising demand from Europe, edible groundnuts are a potentially lucrative market for smallholders. Most African groundnuts command lower prices, however, because they do not meet EU norms for aflatoxin and pesticide residues (Mbaye 2005). African exporters have been largely relegated to the lower value and declining groundnut oil market, or have stopped exporting groundnuts altogether as in Malawi. The Gambia supplies edibles to the European birdfeed market, but even that is in doubt due to complaints of animal rights activists.

Overall, edible groundnuts share some of the same opportunities and challenges as horticulture, as discussed below, in requiring sophisticated knowledge and careful handling. FDI and know-how from experienced international firms is crucial in reviving the groundnut sector. In addition to facilitating entry of foreign and domestic private firms, African governments have a key role to play in assisting producers in meeting ever-higher foreign norms and providing basic infrastructure.

F. Non-Traditional Agricultural Exports

i. Horticulture

Horticultural products, which include vegetables, fruit and cut flowers, have grown steadily and become the single largest category in agricultural trade, accounting for more than 20 percent of world agricultural exports. Horticultural exports from Sub-Saharan Africa (SSA) have expanded and now exceed $2 billion, but represent only 4 percent of the world's total exports (English *et al*., 2004). The EU is the main market for African produce, but regional markets are also promising.

Growers in developing countries have a comparative advantage in horticultural products due to low labor costs and favorable natural resource endowments (World Bank, 2004). Promoting horticultural exports can greatly benefit the LDCs in the following ways. Firstly, horticulture can be an important source of more diversified and higher value non-traditional exports. In contrast to the declining prices of traditional agricultural commodities, prospects for horticultural products are very promising. International demand has been rapidly rising since the mid-1990s (English *et al*., 2004).

Secondly, horticultural production creates employment opportunities for the rural poor, notably women, and has significant impacts on poverty reduction. Studies also show that households who participate in horticultural production, in both rural and urban areas, earn higher incomes than households who do not (McCulloch & Ota, 2002).

Thirdly, horticultural exports can enable LDCs to acquire new knowledge and technology in producing and marketing high-end products (UNCTAD 2000). The perishable nature of the horticultural products and high sanitary and phytosanitary (SPS) standards require technical know-how and quality control. The horticulture industry is characterized by rapid structural change, requiring upgrading by producing countries. Increasingly, distribution is dominated by large supermarket chains with exacting quality standards.

Kenya offers the most often cited success story in horticultural exports in SSA and is the second largest horticultural exporter in SSA, after South Africa. Incomes of horticulture smallholders as well as employees in large farms are well above those of non-horticulture farmers. Several factors have contributed to Kenya's success in horticulture (McCulloch & Ota, 2002; English *et al*., 2004; Tanzania IF, 2005): (i) Kenya's climate is favorable for a wide range of crops. (ii) The early experience with Asian vegetables for the local Asian community and their overseas links allowed Kenya to take advantage of the growing demand for Asian vegetables from immigrants in Europe. (iii) The backward linkages of the thriving tourism industry increased the demand for high quality horticultural products. The development of Nairobi as a tourist destination and regional hub also facilitated the transport of perishable products. (iv) While far from perfect, Kenyan policies were largely favorable to private sector involvement, welcoming to FDI, and focused on aiding the sector while not intervening directly in production and marketing.

The Ugandan floriculture industry is another success story. With substantial donor support (USAID and the Dutch government) and learning by doing, Uganda now dominates exports of sweetheart roses and is an important supplier of chrysanthemum cuttings to the European market. Besides the successful exploitation of climatic advantages and donor support, cooperation amongst growers is also a key factor in Uganda's success. The Ugandan government's overall commitment to improving the business climate and promoting exports underlies the success of the floriculture sector.

Burundi's climate, rainfall, altitude and soil quality are favorable for both tropical and temperate production, but the ethnic conflict between 1993 and 2000 (Burundi DTIS, 2003) undermined the sector and recovery is proving difficult. Burundi lacks regularly scheduled air transport to European markets and refrigeration facilities at the airport force (USAID, 2006). The sector requires substantial investments in infrastructure, quality control, and technology, but these are hampered by ongoing security concerns.

In 1992, Burkina Faso and Senegal had nearly the same level of fresh vegetable exports to the EU. Burkina's exports have plummeted since 1997 in the face of rising competition and the inability to adapt to European quality and sanitary standards. In contrast, Senegal has adapted successfully to the demands of the EU market by shifting from smallholder contract-based farming to large-scale estate production with greater vertical integration, and its fresh vegetable exports have nearly tripled since 1997. As in Kenya, incomes of both contract farmers and employees on large estates producing vegetables for export in Senegal are far above those of non-horticulture households. Moreover, estate farming extends these benefits to a larger number of people (Maertens and Swinnen 2007).

International companies with technical expertise in production, packaging and marketing can serve as crucial intermediaries and transfer technology. For example, Blue Skies, a company based in the UK, exports tropical products from South Africa, Egypt, and Ghana to the EU market. In Ghana, Blue Skies prepares and packages ready-to-eat cut pineapple, papaya, and other tropical fruits in plastic containers for European supermarket shelves. It has rigorous quality control, EUREP-GAP certification and a good reputation amongst supermarkets. It provides capital at low EU rates, technical expertise, and marketing contacts, thus overcoming some of the key constraints in Ghana and elsewhere. Workers receive excellent social and health benefits and jobs in the company are highly sought-after (Burkina DTIS, p. 48).

These case studies illustrate that horticulture is an extremely promising source of export diversification and poverty reduction for many LDCs, especially in Africa. The range of climate conditions suitable for various horticulture products is quite diverse, ranging from Senegal to Uganda and Kenya. An appropriate and flexible policy approach is required, however, to encourage the private sector to respond to the opportunities and challenges of the rapidly-changing world market (Labaste 2005).

Both general (transport, power, telecommunications) and horticulture-specific infrastructure (cold storage areas, irrigation) must be available, as well as a liberal trading environment such that inputs and foreign exchange are readily obtainable. Sufficient air cargo space is a particular concern. There are synergies between horticulture, tourism and air service. Additional tourists increase the demand for horticultural supplies and the supply of air service, and hence shipping of horticultural products.

In successful exporters, government intervention has been minimal, although assistance to growers in the form of extension services and support for producer associations can be helpful. Agents with international connections such as resident Asians or foreign buyers play a crucial role in linking local economies to the international system, providing capital and know-how. Donor assistance can also be important in the initial phases.

ii. Fishing

Demand for fish has increased dramatically in both developed and developing countries in recent years (UNCTAD 2005). The depletion of fishing stocks in developed country waters creates a tremendous opportunity for developing country suppliers. In 2004, the value of net fish exports from developing countries was higher than the combined value of their exports of rice, coffee, sugar and tea (FAO, 2006). In 16 out of 50 LDCs, fish exports are ranked in the top five merchandise exports (UNCTAD 2006, p.146).

In LDCs, artisanal and industrial fishing coexist uneasily. Industrial fishing is dominated by foreign vessels using advanced technologies to catch high-value demersal (offshore) species, often landing little of their catch in the LDCs and contributing to depletion of stocks. Artisanal fishing for demersal as well as smaller pelagic (coastal and riverine) fish is a major source of employment and earnings, but is handicapped by rudimentary infrastructure and poor hygiene. Fish-processing plants are supplied mostly by artisanal fishing, and are also an important source of employment in a number of LDCs.

Besides diversifying exports, creating employment, and increasing foreign exchange earnings, the fishing sector is important for improving food security and interacts with environmental sustainability. LDCs confront several critical issues, including sanitary standards in developed countries, resource management and surveillance, and infrastructure provision.

As for horticulture and groundnuts, fish exports from LDCs face stringent sanitary standards imposed by the advanced economies. Fish require great care and speed in handling and shipping to preserve freshness. Countries such as Bangladesh and Tanzania have shown that investments in raising and enforcing norms can pay off handsomely. Both the US and the EU had instituted bans on fish imports from Bangladesh in recent years. Substantial investments in laboratories and training by exporters and the government in the 1990s, with donor support, notably from the FAO, have raised quality and hygiene standards and the bans have been gradually removed. Similarly, highly sought-after Tanzanian Nile perch from Lack Victoria were banned in 1999 in the EU Effective responses by the government and the trade associations, with donor assistance, have substantially overcome these quality control deficiencies and greatly improved the reputation of Tanzanian fish exports, although at a rather high cost.

Fishing in LDCs suffers from lack of public investments in basic and specialized infrastructure required for the fishery sector. Well targeted investment in infrastructure can reduce export costs and enhance competitiveness, especially for the artisanal sector. Due to deficiencies in infrastructure and in its monitoring, surveillance and control system, for example, Sierra Leone has little ability to export and has not satisfied EU sanitary requirements.

Controlling over-fishing is another huge challenge for LDC fishery administrations with limited administrative capacities and funding. Regional cooperation and assistance from donors can be helpful. The issue of over-fishing of the Lake Victoria Nile perch has been addressed by a World Bank program, fostering more rigorous controls on fishing methods and attempts to restrict cross-border movements of fish, but the efficacy of these measures has not yet been determined. The problem of overfishing has reached a crisis point in Senegal, where the volume of demersal catches fell by 50 percent between 1996 and 2002. The problem is exacerbated by granting of fishing rights to other countries, notably the EU and Japan, although Senegal did not renew the EU's rights in 2006.

A number of LDCs receive foreign exchange earnings by leasing out fishing rights, notably to the EU and Japan. The drawbacks are that the fish are often not processed locally and monitoring of compliance on fishing limits is difficult. Agreements with foreign fleets should be carefully negotiated to ensure that the home country receives adequate benefits. Effective regulation of foreign vessels is indispensable to the sustainable development of the sector. Accords should also provide incentives for local landing and processing, where economically efficient to do so.

G. Manufacturing: The Case of Clothing

Labor-intensive manufactured exports, particularly clothing, to developed countries has been a vital stepping-stone in the economic growth of many labor-abundant developing countries, starting with the East Asian tigers (South Korea, Taiwan, Hong Kong and Singapore) in the 1960s. A highly sophisticated international division of labor has developed over the last few decades, with the most unskilled, labor-intensive operations moving to developing countries with very low wages. Over time, apparel production for export has spread to South-East Asia, China, South Asia, Latin America and North Africa, and most recently, even some countries in Sub-Saharan Africa. Three interrelated forces have contributed to this diffusion of production to LDCs: the rise of global buyer chains, the evolution of labor costs and productivity, and the policies of developed countries.

Global buyer chains. Fiercely competitive global buyers have come to dominate the clothing market and scour the globe for the cheapest sourcing. Global buyers include discount chain stores (e.g., Walmart, Target), branded marketers (Nike, Liz Claiborne), apparel specialty stores (The Limited, The Gap), and private label programs of mass merchandisers (Sears, JC Penney). Large retailers do little of their own manufacturing, and instead subcontract with firms in developing countries, thereby fragmenting and diffusing production around the world (Gereffi 1999). Buyers have exacting quality standards and delivery schedules.

Labor costs and productivity. Wages and productivity evolve over time, leading to changes in competitiveness, in part endogenously in response to exporting. Although clothing production is a seemingly very simple, labor-intensive process, success in exporting depends only in part on low wages. Quality control and rapid turnaround time in responding to orders are crucial, and depend on a country's institutional environment and infrastructure, e.g., ports, customs, electric power, etc. LDCs that upgrade their business climates, even within the focused context of export-processing zones (EPZs), become potential recipients of outsourced labor-intensive production.[*] Moreover, as exports grow, demand for labor rises, local firms acquire greater experience and technological and managerial capabilities, and wages rise, LDCs lose comparative advantage in the most labor-intensive operations and upgrade to more sophisticated products. In the Asian tigers, tremendous technological upgrading through exporting has occurred (Westphal 2002, Lall 2002), and wages have risen some ten-fold or more since the 1960s. Interestingly, however, global buyers still contract with Taiwanese or Korea firms, because of their expertise in clothing manufacturing, and the latter in turn invest in or contract with factories in LDCs with much lower wages than Korea or Taiwan.

[*] Golub, Jones and Kiezkowski (2007) provide empirical evidence that success in attracting FDI in manufacturing and in exporting depends on the quality of a country's trade-related infrastructure (in their terminology, the country's "service links").

Rapid and reliable access to inputs, notably fabric, is critical, but domestic production of textiles may not be efficient, given its high capital intensity. Relying on imported fabric requires an efficient transport system and customs. Regional integration and well-functioning EPZs can also lower transactions costs.

Trade policies in developed countries. Trade restrictions and preferences in developed markets have shaped this process. The boom in exports from developing countries led to protectionist pressures in developed countries, notably the Multi Fiber Arrangement (MFA) established in 1974[*], a global system of quotas. Exports of the most successful Asian exporters such as the 4 tigers and more recently China were tightly constrained by the MFA. The MFA therefore had the unintended benign consequence of spurring global diversification of production, as buyers sought out countries that were not restricted by the quotas. The elimination of the MFA in January 2005 has conversely led to fears that a few dominant producers, notably China, will rapidly dominate the world market and cut off this route to development for LDCs. It is too early to judge the full effect of the end of quotas. China's exports boomed in 2005 and some new exporters, notably in Africa and Latin America, experienced a corresponding sharp drop in exports. US imports of clothing from Sub-Saharan Africa fell sharply from $1.8 billion in 2004 to $1.3 billion in 2006 (US ITC 2006); in the Maldives, the clothing industry has collapsed (Maldives DTIS 2006).

On the other hand, Asian LDCs such as Cambodia, Vietnam and Bangladesh have continued to increase market share. Also, the United States and Europe reinstituted some restrictions on China in 2006 for a two-year period, blurring the situation.

In addition to quotas, clothing is subject to relatively high tariffs in the United States and Europe. Both of the latter have Generalized System of Preferences (GSP) schemes that exempt eligible LDCs from customs duties, but clothing, due to its sensitive nature, is largely excluded. In Europe, clothing imports from LDCs qualify for preferences under the Everything But Arms (EBA) preferential duties but restrictive rules of origin apply to fabric sourcing, limiting the effective generosity of these provisions. The US Africa Growth and Opportunity Act (AGOA) relaxes rules of origin for African LDCs on temporary basis.[†] In combination with the MFA, AGOA has been very successful in jump-starting clothing production in a number of southern and eastern African countries, but the sustainability of their fledgling industries is in doubt due to the temporary nature of AGOA, relentless competition from Asia, and the end of the MFA.

Another issue in developed countries emanates from human-rights groups, who have decried low wages and labor standards in LDCs despite clear evidence that wages in exporting firms, while low, are uniformly superior to the alternatives available to most workers in agriculture and the informal sector (Moran 2002). US preferences and bilateral trade agreements are increasingly contingent on LDCs satisfying labor and environmental standards.

The case studies show that a successful clothing industry can have very large effects on economic growth and poverty reduction. Largely as a result of its booming clothing sector, Bangladesh is the only South Asian country on track to meet the Millenium Development Goals (IMF 2007). In Lesotho, the clothing industry, in cooperation with donors, has launched an initiative against AIDS, with which about 30 percent of textile workers are infected (Economist 2007). In both Bangladesh and Lesotho clothing accounts for 75 percent of export earnings and is the largest source of formal employment. Women account for the bulk of employment in export-oriented clothing factories in these two countries and almost

[*] The MFA was replaced by the Agreement on Textiles and Clothing (ATC) in 1995.

[†] AGOA has been renewed three times. There is a cap on total duty-free African exports that has not been binding. Most importantly, rules of origin on fabric are relaxed such that African producers are allowed to source fabric in Asia rather than in the US or in Africa. This is critical, because fabric is much more capital-intensive than clothing and Asian fabric is cheaper than in Africa or the US. This provision, however, has been highly controversial in the US Congress, which is why the duration of this provision has been more limited than for AGOA as a whole, and currently expires in 2012. See McCormick (2006) and Mattoo, Roy and Subramanian (2002).

everywhere else. Over time, apparel production provides considerable scope for technological upgrading and increasing incomes.

The comparison between Lesotho and Bangladesh, two successful LDC exporters of clothing, reveals some interesting lessons. In both countries, the clothing industry was established by investors seeking alternatives to the binding MFA quotas on East Asian producers. Along with trade preferences, a relatively favorable business climate and low labor costs played important roles. In Bangladesh, the EPZ functioned relatively well despite high levels of corruption in the rest of the economy. Lesotho, a tiny land-locked country in Southern Africa far from its main market in the United States, has become the largest African exporter of apparel under AGOA. Lesotho was attractive relative to other African countries due to its business-friendly government and the incentive to circumvent sanctions on South Africa while still taking advantage of South Africa's excellent roads and ports. Most of the growth of the industry has occurred since the implementation of AGOA, however.

Bangladesh was expected to suffer from the end of the MFA, but exports have continued to grow although not quite as rapidly. The increasing depth of the industry has certainly contributed, as has a competitive and flexible exchange rate. In Lesotho, on the other hand, some 10,000 jobs have been lost since the expiry of the MFA. A key factor has been appreciation of the local currency, which is pegged to the rand; the roots of the industry in Lesotho are also shallower than in Bangladesh where more upgrading and backward linkages have taken place.

Madagascar and Senegal afford another interesting comparison. Clothing has become Madagascar's largest export and a major source of formal employment (IMF 2005, Madagascar DTIS 2003), largely thanks to one of the few successful EPZs in Sub-Saharan Africa (Cling, Razafindrakoto, and Roubard 2005). The 2002 political crisis led to a sharp drop in exports, but recovery has been strong, mainly due to rising exports to the US under AGOA preferences. In contrast, Senegal's clothing exports are negligible despite the country's eligibility for AGOA preferences and its advantages in the form of political stability, a coastal location close to Europe and the USA, highly skilled tailors in the informal sector, and one of the first EPZs in Africa. Senegal's heavily inward-oriented policies towards the textile industry have created a less favorable environment. The Senegalese textile industry is dominated by a few large but less efficient vertically-integrated firms established at the end of the colonial era that retain powerful political connections (Golub and Mbaye 2002). Unlike in Bangladesh and Madagascar, where EPZs insulated exporting firms from the deficiencies of the investment climate and incentive systems generally functioned well, Senegal's EPZ suffered from the same deficiencies of the business climate as the rest of the economy, and incentives are complex and opaque (Senegal DTIS 2003).

H. Tourism

Tourism, the world's largest industry in value, has great economic potential to contribute to growth and poverty alleviation in LDCs, especially through employment creation. Although the LDCs' current world market share of tourism is only about 1 percent, the number of visitors to LDCs jumped 48 percent between 2000 and 2005. Tourism represents one of the few sectors in which LDCs managed to increase their share of world economic activity recently (World Tourism Organization, 2006).

Tourism can generate considerable foreign exchange earnings for LDCs and directly contributes to economic growth. Even more importantly, the highly-labor intensive and diverse nature of the industry also makes it an engine for employment creation, both for the highly skilled and unskilled, in a wide range of geographical areas. Local communities in remote areas and the informal sector can share in the gains (World Tourism Organization, 2006).

In addition, tourism can indirectly contribute to growth through its extensive linkages with other sectors. In LDCs, tourism has significant impacts on fisheries, food processing, horticulture and handicrafts production, sectors that cater to hotels and restaurants and in some cases directly to tourists

(UNCTAD, 2001). Training programs can reduce reliance on expatriates and increase the local content of tourism exports.

Improvements in infrastructure are both a condition and a consequence of a growing tourism industry. An adequate airport with a threshold of international flights is particularly important. Air service is a source of synergy between tourism and horticulture and fishing, through provision of air cargo space. The government should ensure a well-functioning airport and facilitate access by foreign airlines rather than protect incumbent flag carriers.

LDCs face considerable obstacles in fully exploiting the economic potential of tourism, including (i) the requirement of substantial up-front investments in infrastructure and tourist facilities, (ii) inability to fully capture none of the value chain due mainly to insufficient local supply and high import content, and (iii) tourism's vulnerability to various external shocks and pressures on fragile ecosystems.

Environmental and cultural preservation can go hand-in-hand with tourism, as LDCs capitalize on their substantial natural, historical, and cultural assets. In the Maldives, a group of atolls in the Indian Ocean, tourism has become the main industry. The government has understood the importance of environmental protection, and sought a sustainable approach to tourism development. In recent years, the government has encouraged high-end tourism, with luxury resorts that attract a lower volume of higher-spend tourists. Recent social turmoil and political repression could exert a negative influence on tourism if not contained (Economist 2006). Cambodia's cultural and geographic attractions made it a popular Southeast Asian tourist destination during the 1950s and 1960s and again now that the political turmoil of the Khmer Rouge era has been overcome.

The government has a crucial role in fostering a hospitable environment through political stability, infrastructure provision, and a minimum of hassles and red tape. Insecurity is a major deterrent in some countries such as Haiti. A master plan organizing the country's tourism strategy, appropriate destination marketing, and investments in key tourism sites are also important ingredients. An appropriate institutional environment and key public investments complement private investment in hotels, restaurants, and activities. Administrative procedures relating to visas, airport transit, currency conversions, and other transactions required of visitors should be easy for tourists.

For example, although Madagascar has considerable tourism potential there are no direct flights from Asia and the US. High air transport costs are partly the result of lack of competition, since Madagascar has highly protected its national carrier rather than adopting an "open-skies" policy (MIGA, 2007). Airfare accounts for approximately 60 percent of the cost of a tourist package (Madagascar DTIS, 2003). The presence of internationally-recognized flagship resort hotels would significantly increase tourism standards and help promote Madagascar as a tourist destination (Madagascar DTIS, 2003). In addition, poor quality and high costs of telecommunications are detrimental. Reliable and reasonably priced internet connections are an important service demanded by tourists and improve the overall efficiency of the industry.

UNCTAD's studies confirm that incentives are not the best policy instruments to enable countries to attract and benefit from investment. Nevertheless, tourism sector in many countries is not a priority sector and governments often fail to extend investment incentives to tourism. Tourism is not eligible for incentives in Madagascar, for example, because it has not been classified as an export sector by the Malagasy government (Madagascar DTIS, 2003). Other constraints on private investment include complex procedures for land acquisition, difficulty in securing financing, and problems related to economic governance such as pervasive red tape and corruption (Christie, 2005).

I. Conclusions and Recommendations

1. The analysis in this paper leads to the following ten key conclusions and policy recommendations.

Export growth and diversification is a decisive contributor to economic development. Economic growth is primarily a matter of increasing productivity and efficiency. Exporting fosters productivity improvements through a number of channels, including providing foreign exchange earnings that finance imports of capital equipment. Perhaps most importantly, successful exporting is both indicative of and conducive to technological upgrading. In order to penetrate developed country markets LDC exporters must be able to satisfy stringent quality norms and delivery schedules while keeping costs at internationally-competitive levels: successful exporting means passing a market test. Exporting also contributes to poverty reduction through employment generation. Empirical evidence particularly by UNCTAD, the World Bank and the International LAbour Organization (ILO)confirms that workers involved in export sectors earn higher incomes than those engaged in production for the domestic market, most often in subsistence agriculture and the informal sector. Moreover, to the extent that exporting promotes technological advance and efficiency, labor productivity rises, boosting incomes.

2. Manufacturing is an important avenue of export diversification but not the only or even the main one for most LDCs. Export diversification is often associated with manufacturing[*]. But exporting manufactures is difficult for LDCs given daunting competition from Asia and especially China. Moreover, dynamic gains and poverty reduction also accrue from other non-traditional exports such as horticulture, fishing, and tourism, and even from traditional export crops.[†] Our case studies reveal that exporters in these industries face many of the same challenges as clothing and other manufacturing exporters. Like manufacturing firms, horticulture exporters face intense competition and must satisfy the demanding quality and delivery schedules of European and American supermarkets. This requires efficiency in production, handling, and distribution so that fresh produce reaches far-away supermarkets in an appealing and hygienic form. The same applies to fish exports, which must satisfy stringent sanitary controls. The global tourism industry is also highly competitive and a successful country must pass the market test of attracting tourists through provision of a quality product that encompasses transport services, accommodations, attractions, and security. Previous case studies by UNCTAD on Bangladesh[‡],indicate that office services such as call centers and data processing are another promising but so far largely untapped area of potential comparative advantage for some LDCs.

3. LDCs can take much greater advantage of their traditional commodity exports, both for minerals and agricultural commodities.

   a. If credible domestic and international agencies of restraint on rent-seeking can be instituted, presently rising commodity and fuel prices are an opportunity for some LDCs to seize. Minerals and petroleum are subject to the paradox of the resource curse. The large revenues that accrue to mineral-exporting countries have most often proven to be a stimulus to rent-seeking and corruption rather than a source of funding for development and poverty reduction. Yet in a few cases such as Indonesia and Botswana, developing countries have successfully managed resource booms through prudent fiscal management. Developed countries can assist through the Extractive Industries Transparency Initiative and banking sector regulations that undermine safe havens for corrupt money

[*] For example, while recognizing that non-traditional agriculture can contribute to development, Rodrik (2006, p. 1) states that “economic globalization has greatly increased the premium on manufacturing.”

[†] This is consistent with the finding of Soderbom and Teal (2003) that exporting in general, rather than exporting manufactures in particular, is linked to higher growth in Africa.

[‡] see the 2006 LDC Report of UNCTAD and its contribution to the Mid-term Review, by the General Assembly, of the implementation of programme of Action for LDC for the decade 2001-2010 (UNCTAD/LDC/2006/3)

b. Traditional primary agricultural products are susceptible to dynamic gains similar to those in manufacturing and horticulture, but are stymied by incomplete reforms. Edible groundnuts from The Gambia and Senegal, for example, are shut out of the European market due to failure to meet safe levels of aflatoxin contamination and pesticide residues, and therefore face discounted prices on world markets. On the other hand, some LDCs such as Rwanda have upgraded their coffee quality and have found a niche in the specialty coffee industry, thereby greatly raising incomes for growers. The greatest challenges involve advancing the incomplete and partially-successful reform of state-operated marketing boards so as to introduce competition while limiting opportunistic behavior and providing public goods.

4. Nevertheless, the case for diversification remains persuasive because of continued volatility of primary product prices and the uncertainties about long-run price trends. Developing competitive and efficient export industries, however, poses multiple challenges.

5. Market access to developed country markets is a significant barrier for some LDC exports. It is not, however, the main problem. Agricultural export subsidies and import barriers affect relatively few LDC exports and even where they do, LDCs have often demonstrated they can compete, as in the case of cotton. Likewise, preference margins have eroded such that they are also of minor significance for most LDC exports with some notable exceptions such apparel. Overall, domestic supply constraints are more important than market access to foreign markets.

6. The case studies have clearly shown that regional trade arrangements have limited potential to boost trade for most LDCs. Official intra-regional trade between LDCs, especially in Africa, remains very low, despite a proliferation of preferential trading agreements. Regional groups have created a complicated spaghetti bowl of rules of origin which can lead to trade loss, although they can serve as a support group for trade policy reforms.

7. Foreign Direct Investment and other forms of technology transfer are crucial. Foreign firms have the highly-specific production and marketing knowledge and experience to meet the demands of developed country markets for quality control, sanitary standards and delivery schedules. Donors can also play a catalytic role through technical assistance and financing of infrastructure, as the Rwandan coffee case illustrates.

8. The most important condition for boosting exports and attracting FDI is improvement in the domestic business climate, including governmental provision of public goods. LDCs have made impressive progress in macroeconomic stability and trade liberalization, but deeper structural reforms are less advanced. The case studies show that manufacturing, horticulture, fishing and tourism benefit from a favorable overall business climate, encompassing adequate basic infrastructure (transport, power, telecommunications), a viable judiciary system that protects property rights and contracts, security, limited interference in product and labor markets, controls on corruption, and well-functioning public administration for customs, investment approvals, etc. A functional export-processing zone which insulates exporters from a deficient business climate in the rest of the economy, is a possible second-best alternative for manufacturing. Rare examples of success with export processing zones in Africa so far are Moritius and to some extent Egypt and Morocco. Most EPZs in LDCs, especially in Sub Saharan Africa, have not been successful, however.

9. Industrial policies can also play a role, but not of the traditional infant industry form. Protection of inefficient import-competing sectors is a prescription for disaster in LDCs with small markets and weak administrative capacities. Nevertheless, government policies have to be tailored to individual situations and sectors with high potential through provision of infrastructure and technical support. As Hausmann and Rodrik (2006), emphasize, coordination failures and information spillovers justify intervention. Cold storage areas at the airport for horticulture and fish exports, laboratories for testing fish contamination, and modern washing stations for coffee are examples of semi-public goods that the private sector, including foreign investors, may not provide on their own. For fishing and eco-tourism, targeted environmental

protection is important. There are also synergies between tourism and horticulture that can give rise to coordination failures that export promotion agencies can attempt to counter.

10. Governments, however, should eschew detailed intervention in production and pricing, as repeated failures have demonstrated. In Senegal, for example, the groundnut oil and textile industries are not competitive due to long-standing misguided government protection of inefficient incumbent firms; in horticulture, on the other hand, the government has intervened less, and private investment and Senegalese exports have shown remarkable growth.

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II. Selected Country -Case Studies

A. Case study on Uganda[*]

1. Introduction

Uganda has been engaged in efforts to improve its trade performance since the present government first came to power in 1986. A series of measures were instituted and implemented with the intention to boost economic performance and trade. Trade liberalization was an important feature/element of the economic reforms that started in 1987. It is widely accepted that trade can play an important role to bring about development and improve incomes leading to reduction of poverty. However, along the line, there appears to have been variations in this acceptance. Trade liberalization was not accompanied by any other policies to encourage the growth of production and increased trade. As a result, until the coming into force of the East African Customs Union, Uganda had one of the most liberal trade regimes.

Economic management in Uganda is guided by the desire to eradicate poverty. The government's vision is outlined in its Poverty Eradication Action Plan (PEAP) Pillar 1 pillar 2[†]. This highlights the need for continued growth in private investment and trade in Uganda in order for it to meet the objective of rapid and sustained GDP growth. Other policy documents are the Plan for Modernisation of Agriculture (PMA) which details measures for production and competitiveness and provides a framework for transforming subsistence agriculture to a profitable and competitive level. The Medium Term Competitiveness Strategy (MTCS) aimed at reforming infrastructure provision, financial system to better service the business sector's requirements, the tax administration system and commercial judicial system. A follow up arrangement to the MTCS is the Competitiveness and Investment Climate Strategy (2006-2010) focuses on competitiveness and investment climate.

The economic reform achieved macroeconomic stability in 1992 which has been maintained since. Trade liberalization created an open economy with very low tariff levels. The economy responded with commendable real GDP growth rates averaging 6.9% during 1989/90-1998/99. Strong economic growth led to a reduction in the incidence of poverty was reduced from 56% in 1992/93 to 38% in 2002/3.

Growth slowed to an annual average 5.5% during 1999/00-2004/05. Sustained higher economic growth is essential for poverty reduction[‡]. The recent Poverty Assessment (PA)[§] found growing inequality in the country[**]. Given these findings, the PA emphasizes that improving agricultural incomes would need to be a cornerstone of Uganda' poverty reduction strategy, in addition to increasing non-farm earning opportunities to absorb the rapidly growing labour force.

Uganda's trade policy is to transform the economy into a dynamic and competitive economy, in which the trade sector stimulates and sustains the productive sectors to trade, create jobs and move higher

[*] The case study is prepared by Dr. Lindani Ndlovu who worked as senior economist and investment banker with the PTA Bank (Nairobi), Intermarket (Harare) and with the Harare University.

[†] Pillar 1 deals with economic management while Pillar 2 deals with production, competitiveness and incomes.

[‡] There is abundant cross-country evidence on the strong positive relationship between GDP growth and poverty reduction. Demery and Squire (1996), for example, argue that the dominant factor responsible for changes in poverty in SSA during the 1980s is economic growth.

[§] World Bank (2005).

[**] Growing inequality is found between rural and urban areas and regions; between household size groups; and between higher educated and lower educated households.

in the value chain of production. Its basis is the creation of opportunities for equal participation in trade, provision of an enabling environment, mitigation of adverse effects of practices by trading partners, strengthening capacity to engage in trade negotiations to secure markets for her exports and support the country's vision to industrialise.

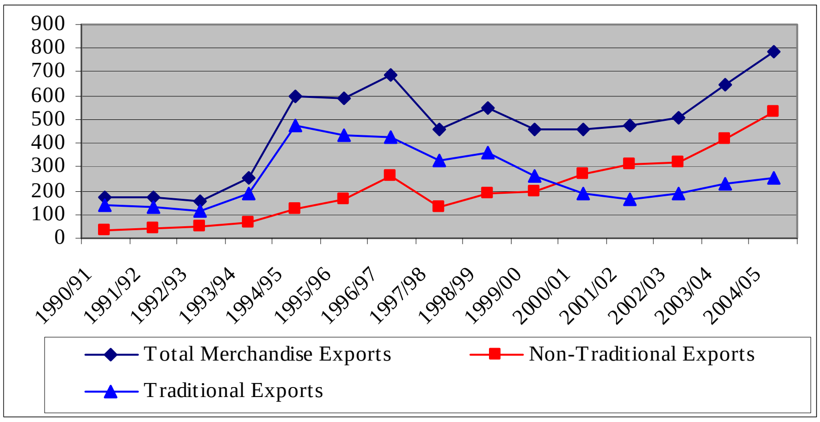
This paper discusses challenges that Uganda faces in raising export performance. It is divided into five sections. Section 2 contextualises Uganda's trade and presents evidence of performance. Section 3 outlines the key challenges the country faces while section 4 attempts some recommended ways of dealing with the challenges. Conclusions are presented in section 5.

2. Context of Uganda's Trade and Performance

The World Bank (DTIS) (2006) observed that Uganda's trade exhibits a very low level of trade integration as measured by the share of exports and imports of goods and services in GDP. Economic growth performance indicates that growth was driven by domestic consumption and its failure to stimulate further growth required that it shifts focus to a more outward oriented or export-driven growth. Agriculture is the lead productive sector and the largest source of Uganda's merchandise exports.

Before we turn to outline constraints to export expansion, we need to look at Uganda's export performance. The country has laboured with production volumes and product quality to stimulate exports. The open and liberal policies have seen imports rise with consumer goods imports exceeding capital goods imports which Uganda has limited capacity to produce. Export performance during 1990/91-2005/06 was an up and down affair. Total exports grew sharply between 1992/93 and 1994/95 and added a further US$100 million over the next two years led by growth in traditional exports up to 1994/95. After that traditional exports started falling. Non traditional exports grew steadily from 1992/93 to 1996/97 and declined before continuing the upward trend again (See Figure 1and Table 1.).

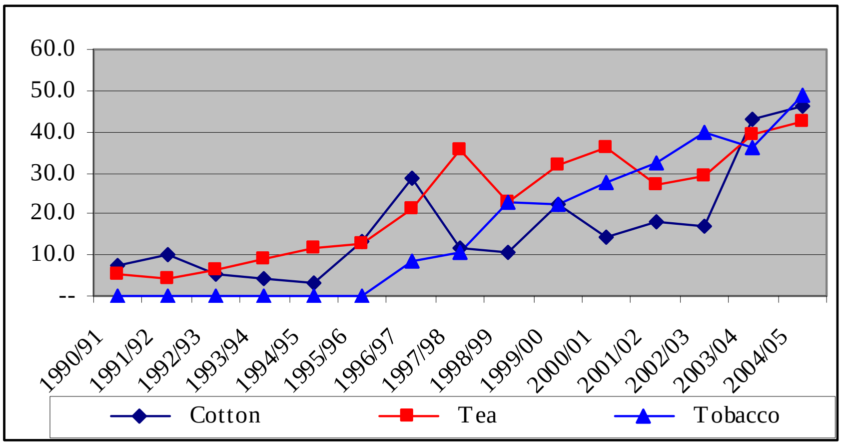
Figure 1: Merchandise Exports: Traditional and Non-Traditional (US$m)



Source: Bank of Uganda (BOU) data.

Major traditional exports are coffee, cotton, tea, and tobacco while the non traditional exports are fish, cut-flowers, electricity, cereals, hides and skins, beans, cobalt. Fish was the dominant NTE; it experienced remarkable growth in the period 1992/93. By 2004/05, it had overtaken coffee as the largest merchandise export. Individual non coffee traditional exports continued to increase (Figure 2).

Figure 2 Non-Coffee Commodity Exports (US $m.)



Source: IMF.

Table 1 also shows the performance of individual traditional and NTEs. Services exports are dominated by tourism which is the lead foreign exchange earner ahead of coffee and fish.

Table 1: Composition of Exports (US$m)

	94/95	95/96	96/97	97/98	98/99	99/00	00/01	01/02	02/03	03/04	04/05
Coffee	456.6	404.4	365.6	268.9	306.7	186.9	109.6	85.3	105.5	114.1	144.5
Cotton	3.3	13.2	28.6	11.4	10.8	22.5	14.1	18.0	16.9	42.8	41.3
Tea	11.8	12.5	21.3	35.6	22.7	31.9	35.9	26.9	29.5	39.3	33.1
Tobacco	--	--	8.6	10.8	22.9	22.4	27.6	32.3	39.9	36.2	36.2
Sub-total	*471.7*	*430.1*	*424.1*	*326.7*	*363.1*	*263.7*	*187.3*	*162.4*	*191.7*	*232.4*	*255.1*
Fish Products	17.0	37.5	34.6	28.0	47.6	24.8	66.6	107.5	111.4	118.1	169.6
Gold [1/]	--	35.2	110.5	25.5	27.9	39.4	58.5	56.7	48.2	58.5	71.3
Flowers	--	--	5.3	6.8	7.2	8.3	13.2	15.9	17.0	27.2	31.7
Electricity	--	--	8.1	12.0	12.3	13.8	16.7	13.9	15.5	12.6	8.3
Maize	20.2	9.4	16.5	8.1	6.1	4.0	6.1	13.1	8.2	18.8	13.3
Hides and Skins	--	--	7.8	7.8	6.6	6.1	22.7	19.6	4.2	5.9	6.4
Cobalt	--	--	--	--	--	7.3	12.8	10.9	1.9	2.7	13.7
Beans	11.7	7.4	6.0	2.2	4.6	4.8	2.0	1.5	5.5	4.9	4.3
Others	74.8	70.7	70.6	41.3	73.7	87.7	72.4	72.5	104.3	166.1	212.6
Sub-total	*123.6*	*160.2*	*259.4*	*131.7*	*186.0*	*196.2*	*271.0*	*311.6*	*316.2*	*414.8*	*531.2*
TOTAL	595.3	590.3	683.5	458.0	549.1	459.9	458.3	474.0	507.9	647.2	786.3

Source: IMF.

Uganda's leading trade partners are the EU and COMESA; COMESA is an important source of imports as well as an export destination for Uganda. It is the second largest regional grouping from which Uganda obtains its imports, and being the source of one-quarter of Uganda's imports.

3. Challenges to export expansion

The slow down in both economic and exports growth indicates limitations of the trade sector and the economy to drive the poverty reduction. Strategies to spur real growth and targeted measures to improve the lot of the poor will require an understanding of the current impediments to growth of the trade sector especially growth of exports as key to unlocking strategies for desired growth. This should be filled by more sustainable sources of growth, in particular from private investment and exports (World Bank, 2006).

Constraints to export expansion in Uganda can be divided into production related as well as trade related or alternatively as economy–wide and sector specific. Addressing economy-wide constraints leads to the creation of a stronger enabling economic and business environment that will support exports the expansion as well as the diversification into other exports. However the provision of an appropriate enabling environment by itself may not be sufficient, and there may also be sector-specific constraints to exports that need to be tackled.

Competitiveness lies at the centre of export performance. In Uganda, it is combination of low volume production and cost of production that undermine exports growth. GOU (2006) identifies key competitiveness challenges as domination of exports by low value, undifferentiated primary commodities that are subject to stagnant world demand and price volatility. Others are lack of skilled labour, lack of specialized equipment, inadequate internal control on quality standards, high fuel prices leading to higher transportation costs. Uganda is a landlocked country. We list and briefly discuss the main challenges below.

3.1 Skilled Labour

Labour is a key competitiveness factor at the firm level. Its productivity determines the competitiveness of the products it produces. Competitiveness is improved by improvements in productivity, efficiency and innovation throughout the value chain. Labour productivity is a key component for product competitiveness. Low labour productivity of Ugandan workers which trails far behind that of regional and international competitors at similar levels of development is a weak platform for launching export expansion (WTO, 2006). The low productivity implies higher costs of labour which directly affect competitiveness. This hinders both expansion of production and the penetration into and sustained presence in export markets.

3.2 Production and quality of goods

Uganda exports agricultural products which are mainly high volume and low value and largely undifferentiated. Production is basically of commodities with minimal processing and value addition. Agricultural production is by subsistence farmers on small plots with very low level mechanisation and use of improved technology. Productivity is low and product quality variable and very often it is difficult to raise meaningful volumes and quantities for export. World commodity prices are known to be very volatile and the experience of Uganda with coffee illustrates this point best. Fish processing was achieved through government policy banning the export of unprocessed fish and bans by the EU.

3.3 Access to and Cost of Finance

Affordable finance is an important input into economic activities underlining the competitive performance of goods. Investors and producers need support through access to affordable finance. However, in Uganda the cost of finance is high and access to credit very low. There is an over-reliance on bank loans and overdraft facilities which are suited to short term needs. A survey of the manufacturing sector revealed that firm owners and managers view financing obstacles as the greatest constraints to firm operation and growth (RPED, 2004). This covers both access to finance (e.g. collateral) and the cost of finance (e.g. interest rates). In the survey, 60% of the manufacturing firms indicated that the cost of finance was a major or severe constraint while 45% viewed access as a major or severe constraint. The two elements constrain growth in Uganda as they affect costs of production in manufacturing and services as part of the supply-side constraints. They cascade into other critical inputs in the production process with the effect that there is a multiplication through high costs of power and telecommunications. The MTCS business environment agenda identified among other things the need to improve access to capital, reducing the risks of lending, promoting savings and expanding financial services for MSMEs to give hope to the disadvantaged. These issues relate to the need for efficient and effective financial services and capital market.

3.4 Infrastructure

Infrastructure in Uganda is a major impediment to export expansion and growth. This covers transport infrastructure (road, rail and air) and production supportive infrastructure, mainly power, telecommunications and water. Transport infrastructure must be supportive of trade in general and export development in particular. Uganda is a landlocked country which places the flow of goods into and out of Uganda out of its control and subject to the control of countries through which it trade routes pass. The efficient flow of goods from a landlocked country requires good roads and railways infrastructure and efficient port handling facilities. Where these are absent, there is an escalation of costs occasioned by the distance to far away ports. Others costs are added by trade facilitation charges in neighbouring countries as goods transit these territories. Delays are often a major cost on both imports and exports making them more expensive and thus less competitive. Mombasa Port handles 95% of Uganda's external trade traffic and problems of congestion increase costs. Customs bonds for exports and imports transiting through Kenya also account for an additional 4% of costs (DTIS, 2006). The poor performance of rail transport in Kenya necessitates intensive use of higher cost road services. In addition, transporting a container from Mombasa to Nairobi is US$700 while for Mombasa to Kampala it costs US$2,000. Also, the cost of transportation of petroleum products by pipeline is excessively high because of the lack of competition from the railways.

Over the last two or so years, Uganda has experienced shortages and unreliable supply of electricity due to limited generation capacity. The effect of this shortage is increased dependence on more expensive thermal power to supplement existing hydro electricity. Individual companies have had to invest in diesel generators adding costs that threaten viability and competitiveness. Telecommunications infrastructure has been provided by two fixed line operators and three mobile telephone operators. However, the opening up or expiry of the protection in the sector has seen entry of other service providers with the opportunity for further reduction of costs.

The influence of infrastructure inadequacies in Uganda extends to area of great potential both for export expansion and employment creation. It affects the tourism, a fast growing export for Uganda. The products are the number of tourist attractions around the country which Uganda has to offer but some are inaccessible because of the infrastructure constraints.

3.5 Real Exchange Rate and Money supply

Uganda has performed well in some important areas; it achieved macroeconomic stability, with single digits inflation since the mid-1990s. High aid inflows have given rise to concerns about the emergence of "Dutch Disease". The World Bank (2007) found that aid inflows increase money supply and real exchange rate appreciation. The increase in money supply requires mopping up through the issuance of treasury bills. The study also found that aid inflows have led to increased investment. However, the study found no evidence that exports growth is driven by variation in real exchange rate. This point on the impact of exchange rate on exports is surprising given its value as an indicator of openness and its impact on profitability of producers and competitiveness. It is worth noting that other factors determine export competitiveness—including all the behind-the-border issues addressed in this report.

Given that Uganda is likely to continue to depend on aid, for the foreseeable future, it is important that aid (and public expenditures) be optimally utilized for generating growth in the country. Aid flows could be important in creation and strengthening of infrastructure would support this aim.

3.6 Inefficiency of Customs Administration

Uganda has made significant progress in the reform to improve customs administration which is acknowledged by private sector groups. The most important priority in this programme is successful implementation of ASYCUDA++. Priority attention is also needed for developing and issuing regulations under the EAC Customs Management Act. It has been observed that there are delays in release of goods which invariably adds to costs. Further improvement in trade facilitation requires increases in appropriate staff and securing necessary training. A risk-based approach should be implemented for: (i) physical inspections of exports involving duty drawbacks and VAT refunds to reduce inefficiency; (ii) in-transit bonds; and (iii) extending inland container depot and warehouse license periods. Valuation practices at border stations should be reviewed to ensure effective application of WTO rules.

3.7 Trade Policy and Regional Trade Arrangements (RTAs)

Uganda is a member of the East African Community (EAC) Customs Union and it adopted the Common External Tariff (CET) in January 2005. Its liberal trade regime characterised by low tariffs levels experience a rise when it joined the EAC customs union; tariff levels were increased. This increased the costs of imports and thus reduced competitiveness of some import-dependent industries. According to the DTIS (2006), this development was anti-poor. Higher tariff increases were on food items which account for a larger share of the expenditures of the poor than the rich. The special tariffs for items on Uganda's sensitive products list were even higher leading to higher consumer prices which hurt the poor consumers more. Basic products such as milk, grains, used clothing, and sugar are included in the sensitive list. The introduction of the CET also increased the risk of welfare-reducing trade diversion, with Uganda replacing less expensive imports from more efficient producers outside the EAC with more expensive imports from its partners.

Uganda is also a member of the Common Market for Eastern and Southern Africa (COMESA) which will form a customs union. Uganda will be confronted with the choice of which agreement to go with. In addition, overlapping RTA membership makes the trade regime difficult to manage and creates scope for conflicting commitments and trade deflection. Continuing existing obligations to COMESA require continued enforcement of border controls to ensure that EAC preferences are not extended to other countries. This compromises the effective functioning of EAC as a customs union and undermines the free internal movement of goods between EAC members. Related to the Uganda could faces problems of conflicting ROO arising from the different RTAs it is party to. Firms could be forced to select and focus on certain export destinations if different rules apply in different markets. Further, firms could incur additional costs to prove compliance with varying ROO across different agreements. Multiple origin schemes further place a burden on the administrative capacity of customs services, and may be subject to abuse.

3.8 Sanitary, Phyto-sanitary (SPS) and Other Standards

Uganda faces challenges in compliance with SPS requirements and product standards for its products destined to developed markets especially Europe. This threatens market access of fish exports to Europe. Additional measures to improve hygiene and safety in the fish export supply chain are required to maintain markets. There are issues of concerns related to policies and strategies to invest in upgrading of landing sites. Maize and coffee also face SPS-related challenges because of potential risks of mycotoxin contamination.

There has been modest success in fostering the development of sustainable SPS/quality management capacities and product quality standards.

3.9 Trade Policy and Export Development Institutions

There are capacity limitations in the Ministry of Tourism, Trade, and Industry (MTTI) have resulted in other ministries and other trade policy institutions that compromise the effectiveness of the key players in the design and implementation of policy.

Since export development in most developing countries including Uganda is mostly concerned with addressing supply side constraints, the Uganda Export Promotion Board (UEPB)—hitherto focused on market entry services—needs to be restructured into a new body with a clear supply-side focus to better meet private sector demands. This new body should be independent, such as a corporation, with its board composed primarily of active exporters.

Further, since export development is really an element of private sector development (PSD), the adequacy of the existing institutional framework for PSD is important. Uganda lacks an effective high-level institutional framework devoted to PSD. There is also no overall GOU PSD strategy although there have been overlapping initiatives aimed towards supporting PSD, most notably the medium-term competitiveness strategy (MTCS) and the strategic export program (SEP).

3.10 Market Access

Although Uganda's exports do not face high tariff or non-tariff barriers, Uganda still needs to ensure secure market access through negotiations at the regional, bilateral and multilateral levels. it is important that she focuses on market access at the Doha negotiations, especially that exports can help poverty reduction. Tariffs reductions by developed and developing countries will erode preferences Uganda currently enjoys in these markets. These threats are a pointer to the need for more efficient and therefore competitive production practices enabling access and entry into key markets. Negotiations with the EU must address and deliver favourable rules of origin (ROO) under the EPA or at least maintain favourable as favourable as those currently enjoyed under Cotonou. Specifically, Uganda should try to obtain "cumulation" (imported inputs processed in other beneficiary countries being allowed for Uganda's exports to the EU), he opening u

4. Some suggested interventions to resolve challenges

In efforts to address the above challenges, it requires the efforts of all parties to pull their weight to bring about positive change especially economic growth where exports play an important part. The main thrust should be on reducing the current high costs doing business in Uganda. Specific interventions designed to deal with specific issues might be necessary. It is so far evident that the stable macroeconomic environment has been inadequate and so while it is necessary, it is not a sufficient condition to achieve export expansion and poverty reduction.

In the area of labour, to improve its productivity, more skills oriented training is necessary to improve productivity. Firms should look at addressing skills challenges through on the job training. However, much of this may have to be handled through attitude and behavioural change. This requires the design of motivational intervention to inject a sense of ownership of the work by workers to stir them into recognising the value of their work and the importance of what they do. In the long term, there may be grounds for changing the curriculum in order to give innovation a boost.

Production and quality can equally be handled through staff motivation but also requires technical capacity including relevant or appropriate technology acquisition for improved performance. Quality assurance schemes and conformity with standards which will be a moving target, will address the issue of quality. Selling to the world requires that there be concerted efforts to benchmark quality of output mindful of the competition on the markets. Uganda maybe small to invest in full scale research and development but this can be done with the aim to unpackage and adapt technology to local conditions and address needs of local producers to enable them compete in international markets. Uganda appears to have some of the infrastructure for this but there would be need to re-jig these institutions and set appropriate targets at the same time ensuring that they adequately resourced for the challenges set for them. Examples of research institutions which would play a key role are UIRI and NARO. Clustering for scale of economies benefits is another way to strengthen the capacity of local producers. In agriculture, creation of conditions for technologically based production capable of producing meaningful volumes would be the way to go. Compliance with set standards can be the only basis on which products will be accepted and ensure expansion. Opportunities for exports exist in agriculture while new and emerging arrangements through contract farming have lifted the level of income for many families.[*]

Cost of finance issues require education of the public about dealing with banks and possible alternatives in the short term especially capital raising through the Uganda Securities Exchange (USE). There is a need for long term facilities which can be accessed both from within Uganda and from outside. It is worth noting that this alternative will be viable for established firms and will exclude small firms. Liberalisation of the pension sector can create a pool of funds that could be channelled to the provision of long term funding. Uganda Development Bank's capacity would have to be increased as it is the one key player in the provision of medium term finance. Associated with this, this challenge could be addressed through the introduction of more innovative financial products through disintermediation. More fundamentally, the introduction of identification cards and broadening the services of a credit service bureau would reduce risk of lenders and cut costs. The treasury bill market should be made less attractive for banks to hold as investment through the introduction of more specialised institutions. Also infrastructure development can contribute to a reduction of bank overheads.

Uganda's absorption capacity for donor aid inflows can be utilised on boosting infrastructure development especially roads. Road construction and maintenance are major investments involving large expenditure that is required to keep traffic and traded goods moving in the process reduce the cost. Further Uganda's disadvantages as a landlocked country, could be tackled through EPA negotiations to request EU support for addressing transport and trade facilitation measures. This would ensure that both infrastructure and trade facilitation would be geared to international levels, giving a reasonable life. There is visible expansion of telecommunications and expected reduction in costs following the end of the duopoly on fixed line network. However, Uganda needs to hook up to the fibre optic cable which will increase the carrying capacity of telecommunications. It is expected that the construction of Bujagali hydro power project that started early in September will resolve the electricity supply problem in four years time. The experience with the power crisis is a learning opportunity for handling the development of the power sector. On the other hand the discovery of oil in western Uganda may provide a reprieve on the cost of petroleum products which have been transported expensively by road from Mombasa. In the meantime, the concessioning of the railway company is set to improve service and reduce cost of transporting fuel and other bulk goods to and from Mombasa as well as reduce journey time. The extension of the Kenya pipeline from Kisumu to Kampala will reduce costs in the medium term.

Uganda can use the current negotiations to lock in and advance reforms in its domestic services sector. The EAC offers opportunities for Uganda to work with partners in advancing its economic progress. In this regard Uganda can push for simple, non-restrictive ROO specifications in RTAs through on-going negotiations. The CET will be part of Uganda's trade policy architecture as the EAC moves towards a common market. As such, Uganda can seek to counter the negative effects of the CET, through reductions in the CET at the next review in 2009 to reduce tariffs since Uganda had the most liberal trade regime before the coming into force of the EAC Customs Union. In addition, further reversal of CET effect can be achieved through the phasing out of the special tariffs on sensitive products in the shortest

[*] Some examples of successful contract farming in Uganda are described by Elepu and Nalukenge (2007).

possible time. This can only be agreed through negotiations with the other partner states in the EAC. Uganda can enhance its regional trade linkages by joining the COMESA Free Trade Area. Uganda should also seek to maintain and even enhance its influence in the Doha Round negotiations.

It has been observed that private investment triggers export growth which in turn causes economic growth. It is imperative that Uganda continues to be an attractive destination of foreign direct investment which can be used for acquiring new technology and skills which can be used to benchmark skills requirements for a growing economy.

Institutional development and the role of government are critical. A stronger MTTI is required to spearhead trade policy design and implementation for export expansion. The institutions that are involved will need to partner and coordinate efforts to grow trade. Such development will be the basis for a strategic development on development and export expansion. Trade issues need to be handled as trade rather revenue or political issues. The Uganda National Bureau of Standards will play an important role in ensuring compliance with international standards. Government through its many institutions must keep improving its facilitation role in tourism, a major source of service exports. For example, it is known that the 1991 ban on the export of unprocessed fish, created conditions for investment in the fish sector in Uganda[*]. Further the ban on fish exports to the EU in 1997 created a culture for compliance with stringent EU conditions among fish processors and exporters. Fish is Uganda’s most successful non-traditional export.

In the present economic environment, there is need for effective consultative mechanism and strong partnership between the private and public sectors to promote Uganda’s interests at home and abroad. Public private partnerships are the way to go where issues and constraints are discussed and ironed out at the same time pursuing practical approaches to mitigate the challenges.

5. Conclusion

The development of trade especially exports in Uganda faces challenges. Export growth offers an opportunity for reducing poverty in the short term. Agriculture, services (tourism) appear to have some excellent opportunities to deliver on poverty reduction. The government needs to address a number of issues through introducing policy that will change attitudes and educate the public about opportunities in trade. The private sector, as the sector that actually trades, can identify opportunities and participate in issues to improve both the policy environment as well as the operational environment to reap benefits through trade.

[*] For a detailed discussion see for exampleDMT (2007).

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The Case study on Rwanda[*]:

1. Introduction: Rwanda Trade and Development Challenges

The main sources of Rwanda's current growth relate to its revitalization programmes and reform policies that followed the 1994 genocide. Nevertheless, key constraints to its growth still pose challenges and difficulties. These include, in particular low level of capital accumulation and failures to improve business infrastructure. While positive developments have been made in the legal and regulatory spheres during the PRSP period of 2001 to 2005, the progress in modernizing and sufficiently investing in the infrastructure was limited. Moreover, resources have been inefficiently allocated in a bid to address other growth impediments including the education and skills development systems, the financial systems and the transformation of agriculture.

The Rwanda's economic growth was characterized, over the last five years, by low productivity, high costs and lack of access to financing, low domestic savings (less than 2% of GDP), poor financial intermediation, and insufficient access to international markets. Because of these adverse factors, as well as due to Rwanda's difficulty in earning foreign exchange resulting from its narrow export base, mobilizing domestic resources continued to be challenging and expensive. This has contributed to Rwanda's dependency on concessional lending and grants from abroad.

Another key constraint to the overall investment relates to the country's state of infrastructure, which significantly affects production and distribution, including exports. This was mainly due to the low level of investment on infrastructure by the government. A deteriorating transportation infrastructure, including an inadequate road network, imposes significant costs on the economy. This particularly increases operating costs and prevents poor communities from being able to trade their products. Further more, the high cost of energy posed a significant constraint on production further undermining the competitiveness of Rwanda in international and regional markets.

The above challenges were thoroughly analyzed and highlighted in the recently undertaken Diagnostic Trade Integration Studies (DTIS) of Rwanda. The primary objective of DTIS was to assist the Government of Rwanda in defining a strategy and an integrated approach towards greater participation in regional and global markets. A key element of the report was an assessment of the main obstacles to trade both within Rwanda and in foreign markets. The study has also identified measures required to mainstream trade in national development policies and strategies. Key policy messages emanated from the DTIS are as follows:

2. Key Lessons, challenges and suggested measures from the DTIS of Rwanda

A. Lessons

Trade can play a key role in achieving the ambitious targets that Rwanda has set for growth and poverty reduction.

Rwanda has initiated a broad economic reform agenda since 1994. The reform and adjustment programmes also include establishing the rule of law, providing macroeconomic stability, establishing

[*] This case study was prepared by Mr.Andre Habimana, Director , Ministry of Finance of Rwanda.

new economic and financial institutions, privatizing state enterprises, developing human resource capacity and building infrastructure. Along these reform agenda, ambitious targets have been set for growth and poverty reduction as contained in the Government's Vision 2020, in the PRSP and in subsequent or second generation Economic Development and Poverty Reduction Strategy (EDPRS). The government has defined a vision of achieving significant progress in social indicators such as educing the share of the population in poverty from the current 60.3 percent to 32.5 by 2015. This is projected to be realized under the baseline average GDP growth scenario of about 6 percent per a year. Currently, the annual export per capita of Rwanda is low even as compared to sub-Saharan African average. There is, therefore, considerable scope, and indeed a necessity, for increasing and expanding exports. Achieving national poverty reduction targets will also require greater involvement of the poor, who overwhelmingly reside in rural areas including those involved in informal commercial activities. This in turn requires the alleviation of a range of constraints that limit their participation in trade, at the national, regional and international levels. For trade to be an engine of growth an a major vehicle for poverty reduction, structural transformation of the rural sector is required. This should be accompanied by sustained efforts to reduce a wide range of supply side constraints.

- Efforts to improve rural incomes need to focus on increasing agricultural production, improving economy-wide productivity including traditional and non-traditional sectors.

In Rwanda, agriculture is the dominant activity with 90 percent of the population living in rural areas. Two aspects of rural poverty in Rwanda are crucial: First, those employed in producing traditional commercial crops for export, coffee and tea, tend to be less poor than farmers involved in non-tradable agricultural produce. Subsistence agriculture still dominates the rural economy. Hence, encouraging farmers to shift into commercial crops, whilst taking measures to raise returns to coffee and tea farmers will have a strong poverty reducing impact. Secondly, working outside of the farming sector is highly correlated with the probability of not being poor. Thus, initiatives that increase opportunities to work outside the farming sector or in high value added non-traditional agricultural sectors (such as horticulture), will also have a significant impact on poverty reduction. However, the small size of the non-farm sector means that, although its incremental contribution to employment growth can be significant, initially its poverty reducing effect could be modest. So, in the short-term, reinforcement of the traditional export sectors through measures that unlock constraints that reduce returns to farmers, by increasing productivity and by raising quality will be the key to poverty reduction. Sustained growth over the medium to long-term will then need to be supported by a flourishing of non-traditional agricultural activities and the non-farm sector.

- Strengthening traditional exports should be viewed as complementary to the overall policy of economic diversification**.**

Increasing returns to coffee farmers will encourage other farmers to shift from subsistence activities into the production of exportable crops. This will also increase the flow of cash into rural areas, thereby, expanding the scope for the development of other marketable activities which will increase the scope for economic specialization. Providing access to transport and reducing transport costs is crucial increasing returns to those producing traditional exports but is also vital in linking rural communities to markets. Access to transport is a key factor affecting the propensity of poor farmers to switch away from subsistence activities into the production of commercial crops. This is also important in allowing other activities such as horticulture and handicrafts in which Rwanda may have natural or comparative advantage.

In Rwanda a substantial increase in non-farm employment is necessary given population growth, the limited availability of land and the need to raise agricultural productivity. The government has identified

Information and Communications Technologies (ICTs) as a key sector to underpin growth in the long run, and to provide employment and to turn the country's population (the majority of which is very young) into a driver of development rather than perceiving it as a constraint.

The ICT sector can contribute in terms of improving productivity in existing sectors and as a source of exports of services in its own right. However, substantial investments in developing human capacity and ICT infrastructure will be required for this vision to come to fruition.

B. Key challenges to Rwanda's trade and competitiveness relate to supply-side constraints

As described above, strong support for traditional sectors with emphasis on developing new higher value-added activities is consistent with the growth strategy of the Government. However, there are still significant barriers that need to be effectively addressed to the full implementation of the growth and poverty reduction strategy of the country.

These constraints are classified into four broad categories in an indicative order of priority as follows:

- BARRIERS THAT DIRECTLY RAISE THE COSTS OF TRADE.

Barriers that increase the cost of trade can also reduce the returns to those involved in trade. Thus such barriers and constraints need to be treated as priority areas for intervention. Conversely, measures that reduce these costs are likely to be more directly translated into higher incomes for the poor so injecting much needed cash into rural areas. Improving returns to commercial activities is a fundamental incentive to encourage other households to shift away from subsistence activities into producing tradable goods and services. However, for this to be effective, it will require the removal of barriers to transition into commercial production, as discussed in priority two below. The main factors that effectively increase the distance of Rwanda from world markets and that directly reduce the returns to trading activities are transport and communication costs as well as costs related to customs.

i. Transport Costs

There are two broad issues in the context of transport. First, is the high cost of transportation, lack of access of the rural poor to transport and the weak transport infrastructure. Currently, rural roads are in poor condition, which substantially increases vehicle operating costs and, therefore, the price of transport services. Improving rural roads will reduce these costs and improve the scope for the provision of effective logistics services. Provided that there is sufficient competition amongst transport providers, lower transport costs will be translated into higher returns to farmers. For many in rural areas, however, there is no effective access to transport services and this is a prohibitive factor in their ability to participate in commercial activities. Improving rural roads will also contribute to expanding opportunities to more rural families to produce tradable goods and services. Poor roads and lack of access to major transport network pose significant constraints, particularly to the development of the tourism sector of Rwanda.

Secondly, the cost and reliability of using the corridor routes that provide access to gateway ports is a severe impediment to Rwanda's capacity to access world markets. The cost per ton of transport from Kigali to Mombasa can be as much as 70 percent higher than that between Kampala and Mombasa. Equally, if not more important than the monetary cost, are the extreme delays that goods to and from Rwanda face in transit along the corridors. The average transit time from Mombasa to Kigali is four weeks. The long delays on these routes reflect congestion in the ports but also substantial procedural obstacles that can explain up to half of the time in transit. Therefore, there is scope to substantially reduce transit times, which will reduce costs and allow for more efficient planning and scheduling of transport services on the corridors.

ii. Customs

Customs clearance time for imports of Rwanda (which currently stands at about 3 days) compares well with other countries in the region. Ongoing computerization and the effective implementation of international approaches to risk assessment, selectivity and valuation systems are expected to further reduce customs clearance times. The average customs clearance time for exports which is currently stands at 2 days can also be perceived as high. Efforts should be made to substantially reduce the current times.

iii. Information and Communications

Access to communications and market information, improving direct contact with buyers, linkages between financial institutions and other Government institutions are key elements in integrating households and firms with markets. They are especially important to facilitate the flow of international trade and encouraging the development of new and differentiated export products. Improving access to low cost ICT services will also be an important factor in determining the flow of information into and out of rural areas. This in turn determines the extent to which rural households can effectively participate in trade and shift towards commercial activities. In addition, as the ICT sector develops, it is expected that opportunities for exports of software and other ICT services will become available. This will reinforce the role of the ICT sector especially in creating employment opportunities that will be needed as the rural sector develops and agricultural productivity improves. However, this will very much depend improvement in the Rwandan educational system. Whilst the government has enumerated a strong ICT strategy, infrastructure, institutions and human capacity remain weak and limit the role of ICT in stimulating trade and development. The spread of ICT services will also depend on the provision of modern and alternative energy supplies, especially in rural areas.

- BARRIERS THAT CONSTRAIN THE ABILITY OF PRODUCERS IN RWANDA TO MOVE INTO NEW ACTIVITIES AND TAKE ADVANTAGE OF TRADE OPPORTUNITIES

Unlocking domestic constraints and reducing costs to business will increase returns to commercial production, which eventually serve as incentives to move into new or non-traditional commercial activities. However, constraints that undermine the ability of farmers to move into production of commercial crops and non-farm activities are of significant challenge to Rwanda. Such barriers also undermine Government efforts to undertake policy reforms and adjustment programmes. Thus, the key constraints that limit supply responses, as shown below should be effectively addressed.

i. Lack of access to credit

Shifting from subsistence into commercial production requires substantially increased financial resources. Resources are particularly needed to purchase new plants or materials, to cover the initial period when the new activities do not generate income and to protect against the higher risks that accompany the higher returns from producing for commercial sale. However, financial resources are simply not available to most households in rural areas. Currently, only 2.3 per cent of bank credit is used to finance activities in the agricultural sector (which employs 80 per cent of the population and accounts for 40 percent of the GDP). This reflects, but at the same time confines the rural sector to subsistence and informal activities. Although important, microfinance schemes cannot provide comprehensive solutions to this problem. Without an increase in the activities of formal financial institutions in rural areas, there will be little success in raising incentives to commercial production and in stimulating monetization and the development of rural markets.

ii. Lack of organization of the rural sector

The lack of effective organization of the rural sector is a substantial barrier to the emergence of market oriented activities. The highly fragmented nature of the rural economy limits the scope for financial intermediation in rural areas and constrains the emergence of effective supply chains linking rural producers to local, regional, national and international markets. A key initiative will be to strengthen the role of cooperatives, first, by clarifying their legal standing and then by enhancing their capacities to mobilize and organize members, to develop business plans and to attract and manage credit facilities.

iii. Lack of access to energy sources

Access to modern energy (electricity and petrol) is crucial to export diversification, farm and non-farm growth which leads to poverty reduction. Attempts to add value to exportable products often depend on the availability and reliability of modern energy supplies. Access to electricity is a highly significant determinant of the probability of being poor.

iv. Lack of extension services

Farmers need advisory services and assistance if they are to shift into new activities that require new techniques and skills. For example, to achieve the objectives of the coffee strategy of the Government, farmers will require extensive training in all aspects of production, ranging from planting through care and maintenance to harvesting and transportation. In Rwanda, about half a million farmers need such supports and training activities.

The first two broad constraints discussed above should be addressed effectively and form priority areas for intervention. Removing these constraints is fundamental to increasing returns to tradable activities in rural areas and to adapt to the opportunities that are available to produce commercial crops and to shift into non-traditional products. Whilst support for traditional activities should be seen as an important mechanism for poverty alleviation in the short-run, there should be a substantial expansion of private sector activities in Rwanda, if the longer term objective of sustained growth is to be realized. Providing an environment conducive for investment and private sector development is, therefore, a critical requirement for long-run growth, employment generation and poverty reduction.

C. MEASURES TO IMPROVE CLAIMATE FOR INVESTMENT AND FOR PRIVATE SECTOR DEVELOPMENT

Substantial steps have been undertaken by the Government towards creating a new business environment which will enhance the competitiveness of Rwanda firms. However, there is still further efforts are needed, particularly to further reduce the costs of doing business in Rwanda and to make the business climate more favourable to both domestic and foreign investments. For instance, legal reform is incomplete and there is a need to further strengthen the legal system and the capacity of legal professionals to effectively and consistently apply business laws. Furthermore, regulations related to land ownership, and improving the services of the "cadastre system" introduced to modernize land ownership and facilitate land registration are of particular importance. Equally important is the need to formulate rules on competition policy and intellectual property rights in order to support the implementation of the ICT strategy of the country. Key elements of the costs of doing business such as the cost of starting a business, the time and cost of registering property and the ability to effectively enforce contracts remain high. There is plenty of scope to streamline business regulations, increase transparency and reduce the costs for firms in complying with the existing rules and regulations of Rwanda.

A further requirement to support private sector development will be the provision of reliable supplies of electricity**.** This will necessitate fundamental restructuring of current electricity tariffs. A solution should also be found for the severe financial imbalances in the energy sector.

- DTIS SUGGESTED MEASURES TO SUPPORT TRADE AND EXPORT DIVERSIFICATION**.**

There is a need to strengthen institutions that support trade and investment and that will be crucial in facilitating the move to a more diversified export base. The key institutions are those responsible for (i) designing trade policy and representing Rwanda's interests in regional and multilateral negotiations; (ii) export promotion and export development; and (iii) standards and quality.

(i) Trade policy should be used to support development by reducing duties on raw materials to zero and by lowering tariffs on finished products, by joining the WTO Information Technology Agreement and by liberalizing ICT-related services sectors. The latter is particularly essential to support and enhance the implementation of the ICT strategy. Such a move would provide a clear signal to investors both within and outside of Rwanda of the government's commitment to a strong and open policy towards ICT. There is strong need for technical assistance, to enhance analytical capacities and support negotiating capacities of Rwanda. In preferential and regional agreements, Rwanda will be pushing for more development-friendly rules of origin and for progress on opening up the services sector. Technical assistance is also needed to improve the quality of trade data. Reliable data are essential for trade policy analysis, for designing and implementing effective export promotion strategy.

(ii) Effective export promotion strategies are required to provide for sustained export growth and diversification, particularly towards non-traditional exports. Current export promotion strategies and initiatives in Rwanda are fragmented, not well coordinated and incomplete**.** There is an urgent need to coordinate and systematise ongoing efforts in this area.

(iii) Diversification of exports into higher value-added products, such as horticulture, will require building the country's food safety and sanitary and phytosanitary management capacities and addressing the weaknesses that undermine product quality**.** The priority here should be investments in promoting awareness, recognition and application of best practices for improving hygiene and safety among farmers and entrepreneurs as the basis for a strong food standards system. Technical assistance and training on best agricultural practices and Hazard Analysis and Critical Control Points (HACCP) are also essential to support the export strategy for processed agricultural products.

The above discussions focus on the broad economy-wide constraints that constrain trade and growth potential of Rwanda as identified in the DTIS. This report also identifies a number of complementary sector-specific initiatives in the key sectors of coffee, tea and tourism that are key to achieve the growth and poverty reduction targets contained in policy documents of the country. Generally, these requires, among other things, the need to strengthen institutions with particular responsibility for these sectors and to raise sector-specific skills. For instance, within the tea sector, there is a particular need to address the issues of pricing and privatization, which are necessary for the country's strategy of raising quality and productivity to become successful.

Finally, certain sectors such as the ICTs, horticulture and handicrafts, hides and skins and minerals have been identified as having huge potential for diversification of the Rwandan economy. These sectors also have the potential for and strong impact on poverty reduction. However, like other sectors of the economy, these specific sectors suffer from constraints related to weak physical infrastructure and low human resources capacity which must be effectively addressed, if these sectors are to flourish. A more effective organization of the rural sector including strengthening of cooperatives will be required for the transfer of technology and technological know-how that are necessary to comply with quality and other industry standards and regulations in importing countries.

3. ECONOMIC DEVELOPMENT AND POVERTY REDUCTION STRATEGIES (EDPRS) FOR 2008-2012: PANNED SOLUTIONS

In agriculture, the main programmes identified in EDPRS 2008-20012 include: intensification of sustainable production systems in crop cultivation and animal husbandry; building technical and organisational capacity of farmers; promoting commodity diversification and agribusiness, and strengthening the institutional framework of the agricultural sector at central and local level. Environmental and land management priorities involve the protection of ecosystems, the rehabilitation of degraded areas and strengthening newly established central and decentralised institutions. Special attention will be paid to sustainable land tenure security through the planning and management of land registration and rational land use, soil and water conservation, reforestation, preservation of biological diversity and adaptation and mitigation against impacts of climate change.

In education and skills development, the emphasis is on increasing the coverage and the quality of nine year basic education, strengthening Technical and Vocational Education and Training (TVET), and improving the quality of tertiary education. Concerted effort will be needed to build scientific capacity including knowledge creation, acquisition and transfer as well as developing a culture of innovation including through protecting intellectual property rights.

In infrastructure, the objectives are to reduce transport costs within the country and between Rwanda and the outside world, and to ensure security of energy supplies by increasing domestic energy production from several sources. Efforts will be made to promote investment in, and the growth of, the Information and Communications Technology industry. In meteorology, the aim is to provide a wide range of timely, high quality information to different groups of users.

In addition to reducing the costs of doing business, the Government of Rwanda (GoR) will promote competitiveness and private sector development through capacity building initiatives, expanding credit schemes and by putting in place Business Development Services (BDS). In manufacturing, GoR will promote value addition in existing product lines in agro-processing, including coffee and tea, handicrafts and mining, and development of new products including silk, pyrethrum, hides and skins and flowers. GoR will also provide the incentives for foreign direct investment and create industrial parks and export processing zones.

The service sector is fundamental for the transition towards knowledge-based society. GoR will exploit the country's potential comparative advantages in financial services, tourism, transport and logistics. The financial sector will be opened-up further to foreign capital, modern and dynamic management and technologies. The financial sector strategy focuses on four areas: improving banking services and access to credit; establishing long-term finance and capital markets, strengthening contractual savings regulation, and developing payments systems.

GoR will promote tourism opportunities by improving tourism infrastructure and services, creating more attractions, including eco-tourism and cultural sites, encouraging private sector investment, better marketing and forming regional and international links.

The governance programme puts emphasis on supporting the development of "soft infrastructure" for the private sector through implementing commercial laws, business and land registration programmes, improving economic freedoms including the regulatory and licensing environment for doing business, and promoting principles of modern corporate governance. The programme covers a wide range of public sector reforms which include deepening decentralisation and enhancing accountability at all levels of government, enhancing public sector capacity, strengthening public financial management and improving procurement, institutionalising performance-based budgeting and increasing the transparency and predictability of policy-making.

III. Policy Conclusions and lessons learned

The work undertaken by UNCTAD including under this project consistently reveals heterogeneity among the least developed countries in terms of export competitiveness and their overall economic performance. Where progress has been observed, it has generally been based on improved world commodity market prices for some commodities, combined with sound economic policies which have improved the business environment and enhanced investor confidence. The key policy lessons that could be drawn from the research work and national cases studies undertaken in the context of the project include the following:

- **First**, the recent expansion of exports and economic growth in LDCs has not been accompanied by an increase in value-addition. In other words, there is a lack of economy-wide improvement in terms of productivity, value-added by domestic producers and long-term structural change in LDCs. The increase in export earnings of these countries is simply the result of improvements in world commodity prices and growth in traditional exports such as oil, copper, coffee, cocoa and groundnuts. Tourism and travel related services have also contributed to this modest upsurge in export earnings of LDCs. While such an improvement is a cause for optimism, there is a concern that it has not been accompanied by structural transformation in their economies, implying high degree of vulnerability to shocks and crises. Therefore, in order for LDCs to take advantage of globalization, while minimizing its risks, they should diversify their economic base through developing their productive capacities into production of higher value - added goods and services leading to fundamental socio-economic transformation.
- **Second**, gains from decades of liberalization policies and strategies are short of expectations. For the last several decades, most LDCs have been pursuing wide-ranging economic reform and adjustment programmes, aimed at trade liberalization. Virtually all have removed the most egregious forms of anti-export bias and many have begun the arduous process – critical to manufacturing success but of fundamental relevance for other sectors as well – of improving the institutional environment for private-sector investment and addressing supply-side constraints. These policies and measures were unable to generate the form and quality of growth that reverses their continued marginalization. Their persistent under-development and in many cases, long term decline, illustrates how trade and integration may be necessary but not sufficient for development and poverty reduction. In fact, despite strong market integration, the current situation in the LDCs is one in which there is liberalization without technological learning and global integration without innovation. This does not mean that protectionism is the best option for these countries. In fact, they should avoid any attempt or temptation to resort to protectionist policies. They should, instead, design their home-grown and endogenous development policies and strategies based on their specific socio-economic circumstances, resources base, institutional capability and overall local conditions.
- **Thirdly,** there is a need for a paradigm shift in development policies and strategies in LDCs. UNCTAD has been advocating, for several years now, that there is a need for a paradigm shift in designing development policies and strategies in the least developed countries. This means that, at the national level, it is important to place the development of productive capacities - and related expansion of productive employment - at the heart of national policies and strategies, including poverty reduction strategy papers. This requires, among other things, a better balance in the allocation of public resources to productive sectors and social sectors. It also requires pro-active policies to induce and coordinate investment to increase value-added and to ensure that the development of productive capacities occurs in a way which generates employment opportunities. In this regard, the ongoing Aid for Trade Initiative should substantially contribute to efforts to

build institutional capacities in LDCs to enable them to formulate locally owned trade policies and enhance their participation in trade negotiations. Aid for Trade should also include assistance to build supply-side capacities, including trade-related infrastructure in these countries.

- **Fourthly,** in the short- to - medium term growth prospects of LDCs could be enhanced by improving their export competitiveness, particularly in areas where they have comparative advantages. In fact, as argued in chapter I of the report, export growth and diversification is a decisive contributor to economic development. The case for diversification remains persuasive more today than ever before because of continued volatility of primary product prices and the uncertainties about long-run price trends. The research and national cases studies clearly demonstrate that in the short to medium-term, there is considerable scope for many LDCs to join the group of successful exporters, in traditional exports such as oil, copper, coffee, cocoa and groundnuts, as most of these products are not produced in developed countries. Non-traditional export areas for LDCs, with significant growth potential include: horticulture, fishing and tourism. For instance, horticultural exports from Sub-Saharan Africa (SSA) have expanded and now exceed $2 billion, but represent only 4 percent of the world's total exports. Furthermore, for fish and fishery products, demand has been steadily growing in both developed and developing countries. In 16 out of 50 LDCs, fish exports are ranked in the top five merchandise exports. However, fish and horticultural products are perishable in nature. This, coupled with high sanitary and phytosanitary (SPS) standards required by developed country markets, undermined the potential contribution of these sectors. Notwithstanding this, countries such as Bangladesh and Tanzania have shown that investments in raising and enforcing norms and standards, particularly on fish exports, can significantly boost their export earnings. Tourism, the world's largest industry in value, also has great economic potential to contribute to growth and poverty reduction efforts in LDCs. Although the LDCs' current world market share of tourism is only about 1 percent, the number of visitors to LDCs jumped 48 percent between 2000 and 2005. Tourism represents one of the few sectors in which LDCs managed to increase their share of world economic activity recently. However, like other sectors, LDCs face considerable obstacles in fully exploiting the economic potential of tourism. Particularly the sector is characterized by lack of investments in infrastructure and tourist facilities, high leakages of tourist receipts out of LDCs' economies due to insufficient local supply and high import content, and tourism's vulnerability to various external shocks and pressures on fragile ecosystems. In some countries, political instability and insecurity, high cost of air transport and telecommunications, have greatly hampered the potential contribution of the tourism sector to their growth and development.
- **Fifth,** despite the increasing number of regional trading groups, particularly in Africa, the official intra-African trade flows remain very low, accounting for less that 10 per cent of total African exports and imports (Excluding South Africa). One of the disadvantages of regional trade blocks is that they create complex rules of origin of rules of origin and discriminatory trade taxes, leading to possible trade loss or trade diversion. Policies and measures to deepen regional integration should address the existing handicaps including illegal trade, transit-transport problems. Efforts should also be made to simplify the rules of origin and trade taxes as well as to harmonize trade with other development policies and strategies. Similarly the Economic Partnership Agreements (EPAS) between the EU and the African, Caribbean and Pacific (ACP) Countries could involve significant costs to the latter particularly from forgone tariff revenue, reduced intra-regional trade, and increased pressure on local industry, that more than outweigh any benefits of greater access to the EU market (Hinkle and Newfarmer 2006), given the generally low EU MFN tariff barriers. In negotiating EPAs, therefore, the LDCs should seek to ensure that these agreements promote their development objectives, particularly through strengthening their productive and supply capacities and contribute to consolidating regional integration processes.
- **Finally**, traditional agricultural crops such as cotton and coffee, like horticulture, have much in common with manufacturing in generating dynamic gains in the form of technological upgrading, quality control, marketing connections. To a lesser extent, learning and efficiency gains are also

possible in mining and energy industries; for the latter, however, coming to grips with the resource curse is the most important condition. While foreign assistance can contribute to export development in all sectors, the fundamental requirement for success is that LDCs alleviate the supply constraints and governance failures that have held them back to date. Our approach is to examine case studies across a range of export sectors of major interest to LDCs. Our findings suggest considerable grounds for optimism for those countries whose governments are able to commit to the necessary institutional and policy reforms at the macroeconomic and industry levels.

V. Recommendations: Negotiating proposals

Sub-theme 1: Enhancing coherence at all levels for sustainable economic development and poverty reduction in global policymaking, including the contribution of regional approaches.

Challenges for LDCs in the context of globalization:

1. There is an emerging consensus now that the process of globalization has presented both opportunities and challenges to all peoples, countries and regions of the world. The least developed countries (LDCs) are yet to reap the full benefits of globalization and are lagging behind other developing countries, particularly in economic growth, technological progress and income. The current form of growth is not leading to structural transformation in these countries and sustainability of growth remains a challenge.
2. The marginalization of LDCs is evident from their negligible share in world trade, international investment and financial flows, and technology. LDCs with nearly 12 per cent of the global population contributed only 0.69 percent of global output in 2005[*]. Their share in world merchandise export also fell from 2.95 percent in 1950 to 0.67 percent in 2004, while the nominal value of merchandise exports declined in 23 LDCs between 2000 and 2002[†]. Currently, the share of LDCs stands at about 0.5 per cent of world exports and 0.7 per cent of world imports. Despite strong market integration, what is being seen in LDCs is liberalization without technological learning and innovation.
3. The challenges facing LDCs are multiple and complex. These include: massive poverty and under-development, lack of infrastructure, weak supply capacities lack of institutional and technological capabilities, low labour productivity, weak statistical base, brain-drain and lack of domestic resources for development. These are further reinforced by civil strife and conflict; political instability; desertification, drought and land degradation; high population growth and ill-health which hinder the growth and development prospects of LDCs. Most LDCs are also landlocked while some others are small island developing States. This physical handicap and the high transit-transport cost associated with it, have further compounded the ability of LDCs to produce and trade on the regional and international markets, thus, undermining their international competitiveness.
4. However, LDCs are diverse in their performance. In recent years a few LDCs have made some progress in achieving the agreed targets on primary education, eliminating gender disparities in education and in attaining a 7 per cent GDP growth rate‡. This modest progress in some areas has been accompanied by improved national policies, increased world commodity prices and strengthened partnership with international community.

Actions and policies required at all levels

5. There is no simple, uniform and universal blue print that enables LDCs to arrest and reverse their continued marginalization. LDCs should design their home-grown and endogenous development policies and strategies based on their specific socio-economic circumstances, resources base,

[*] [www.worldbank.org/DATASTATISTICS],Key Development Data and Statistics, World Bank Database, 2005

[†] World Trade Organization (WTO) 2006 Trade Report.

[‡] Refers to the agreed GDP growth target contained in the Programme of Action for LDCs for the decade 2001-2010, which was adopted at the Third UN-Conference on LDCs (UNLDCIII) in Brussels in 2001.

institutional capability and overall local conditions. They should assume primary responsibility of ownership and leadership in designing and implementing their development policies and strategies.

6. With a view to enhancing the benefits of global integration, the LDCs need to diversify their economic basis through developing their productive capacities into production of higher value - added goods and services leading to structural transformation. They should also encourage private sector development by creating an enabling environment through stable fiscal and monetary policy, stable investment regimes and sound financial systems.
7. However, national efforts and policies alone are not sufficient to effectively address complex development problems facing LDCs. Global action is crucial both to ensure that opportunities from globalization benefit poor people in poor countries and to manage risks of insecurity and exclusion that the least developed countries face today. This should include, in particular bridging the digital and knowledge divide, opening the markets of rich countries to the goods and services of LDCs, providing financial resources including through ODA and debt relief, and realigning international support measures to the needs and priorities of LDCs.
8. The external economic environment has recently witnessed some improvement for LDCs. World commodity prices for their key exports have continued to improve and foreign aid more than doubled between 1999 and 2004[*]. Foreign direct investment flows to LDCs have also shown modest increase since recent years, reaching US$ 9.7 billion in 2005, although FDI flows still remain heavily concentrated in few countries and sectors.
9. Efforts should be redoubled to sustain the recent progress in partnership and shared responsibility so as to substantially improve the performance of LDCs in poverty reduction. To that end, LDCs and their development partners should strive to improve the quality of growth which should be inclusive, participatory and sustainable. LDCs and their development partners should also make efforts to ensure strengthened and mutual accountability in development cooperation through the establishment of effective monitoring and evaluation mechanisms at the national level.

Policy Coherence

10. International policies and rules governing trade, investment, finance and environment should work in harmony and in coherence with national policies and strategies including PRSPs. In many LDCs, Poverty Reduction Strategy Papers (PRSPs) have provided a framework for coordinating national and donor policies. However, the growing multiplicity of uncoordinated policies and programmes have resulted in "policy and process overload" in most LDCs. Governments in these countries strive to implement different international frameworks of cooperation in parallel with their national development policies and strategies.
11. In most cases, the objectives and priorities of the various frameworks, policies and programmes are often viewed as competing with, instead of complementing each other. As clearly stated in the Paris Declaration on Aid Effectiveness, there is, therefore, an urgent need to ensure coherence and consistency as well as strengthen coordination among the different policies, strategies and initiatives at the national, regional and international levels.
12. The Economic Partnership Arrangements (EPAs) with the EU can be important for beneficiary LDCs. In negotiating EPAs the LDCs should seek to ensure that these agreements are coherent and consistent with their development policies and strategies as well as with Multilateral Trade Agreements. Particularly EPAs should: a) promote their development objectives, particularly through strengthening their productive and supply capacities, including transfer of technology, knowledge and technological know-how; b) contribute to consolidating regional integration

[*] UNCTAD Least Developed Countries Report: 2004, :2006

processes; and c) enhance inward FDI flows including its sectoral orientations. Flexible provisions and long transition periods may also be required to minimize the costs and potentially adverse impacts of adjustment and reform in LDCs.

Sub-theme 2: Key trade and development issues and the new realities in the geography of the world economy.

Trade policy Challenges for LDCs

13. Over the last several decades, most LDCs have pursued wide-ranging economic reforms adjustment programmes, notably aimed at trade liberalization,. Trade can be an engine of growth and trade liberalization can create substantial benefits but only when countries have the necessary infrastructure and institutions to underpin strong supply responses.
14. In the case of LDCs, trade liberalization has not resulted in substantial socio-economic benefits and structural transformation. In fact, their share of world trade has continued to decline over the years and remains marginal, accounting for an average of 0.5 per cent of world exports and 0.7 per cent of world imports in 2002–2005.
15. Trade liberalization in LDCs should be gradual, better designed and properly sequenced based on country specific circumstances. It should be linked to the development of supply capacities and realigned with the development priorities and objectives of implementing countries.
16. The most important condition for boosting exports and attracting FDI to productive sectors is improvement in the domestic business climate, including governmental provision of public goods. LDCs have made impressive progress in ensuring macroeconomic stability and trade liberalization. They should make further efforts to sustain and deepen their reform efforts including structural and institutional reforms.
17. Trade should be mainstreamed and sufficiently integrated within national development policies and strategies including the PRSPs. However, poverty reduction strategies in LDCs should pay particular attention to building productive capacities and generating more employment opportunities.

International Support Measures

18. Greater engagement of LDCs with the international economy as part of a carefully sequenced process of liberalisation, matched by increased assistance in strengthening the domestic economy’s capacity to adjust and respond to new trading opportunities, can make a significant contribution to the growth and development of LDCs' economies.
19. In this regard, the current Doha Round of WTO negotiations need be complemented by significant Aid for Trade for the LDCs. Aid for Trade Initiative should include trade related technical assistance to build capacities to formulate a locally owned trade policy, participate in trade negotiations, and implement trade agreements. It should also include assistance to build supply-side capacities, including trade related infrastructure. The Enhanced Integrated Framework for Trade-related Technical Assistance to LDCs (EIF) which is an important vehicle to strengthen the institutional capacities of LDCs should be further strengthened through the Aid for Trade Initiative.
20. The importance of trade preferences in jump-starting the manufacturing sector in some LDCs is crucial especially in textiles and apparel where preference margins remain substantial and where LDCs have potential comparative advantage. Efforts should be made, particularly to secure more simplified, flexible and liberal rules of origin for LDCs.

21. Moreover, market access conditions for LDCs need to be further improved, made more predictable and sustainable through the elimination of remaining tariff and non-tariff barriers, relaxation of rules of origin, expansion of product coverage and simplification of administrative procedures in relation to the GSP and other market access arrangements. In this regard, the decision taken in the WTO Ministerial Meeting in Hong Kong on duty-free and quota-free market access for products originating from LDCs should be implemented as soon as possible, preferably by 2008. Administrative procedures in relation to the GSP and other market access arrangements also need to be simplified. Special and Differential treatments in favour of LDCs should also be made operational, more effective, sustainable and mandatory.
22. It is recognized that MFN tariff liberalization would erode preference margins enjoyed by the LDCs. In this regard, negotiations in the WTO should incorporate provisions to address the erosion of preferences, including longer implementation period of tariff reduction of products identified by LDCs as vulnerable to preference erosion.
23. In view of the growing importance of service exports from LDCs, the modalities for special treatment for LDCs in the WTO negotiations on trade in services should be fully implemented. In this regard, priority needs to be accorded to methods and supply of export interest to LDCs, in particular, on movement of natural persons under mode 4.
24. Regional economic and trading groups are also proliferating in the developing world. In Africa alone there are some 30 regional groups, and on average each of the 53 countries on the continent is a member of 4 (typically overlapping) groups. Yet official intra-African trade flows remain very low at less that 10 per cent. A drawback of regional trade blocs is that they create complex rules of origin and discriminatory trade taxes, leading to possible trade loss or diversion. Efforts to deepen regional integration should be pursued, particularly to simplify the rules of origin and trade taxes as well as to harmonize trade with other development policies and strategies.
25. EPAs could involve significant costs to ACP countries from forgone tariff revenue, reduced intra-regional trade, and increased pressure on local agriculture, industry and services sectors. These possible negative impacts of EPA are more likely to outweigh the potential benefits of greater access to the EU market, particularly given the generally low EU MFN tariff levels. EPAs could also impose on LDCs trade rules and obligations that go beyond the current Multilateral Trade Agreements in areas such as TRIPs, investment and services.
26. The complex and costly accession processes of the WTO are beyond the financial, technical and human resources capacities of LDCs. LDCs that are in the WTO accession process should be provided with adequate financial and technical assistance to adjust and build their institutional, regulatory and administrative capacities. The accession processes, procedures and requirements should, therefore, be simplified and tailored to the developmental needs and objectives of LDCs. Acceding LDCs should not assume commitments and obligations that go beyond what the current developing country members of the WTO had undertaken
27. UNCTAD should continue and strengthen its assistance provided to the LDCs, acceding to the WTO. In this regard, UNCTAD in collaboration with relevant organizations, will seek to undertake a review of the guidelines for LDC accessions agreed in 2002 in the WTO so as to examine whether the letters and spirits of the guidelines are adhered to by WTO members and whether the guidelines are facilitating the accession of LDCs into the WTO.
28. South-South cooperation especially the Global system of Trade Preferences among developing countries (GSTP) should be strengthened taking into account the special trade and economic needs and prospects of LDCs.
29. UNCTAD should analyse the opportunities arising from flexibilities available to the LDCs in Multilateral Trade Agreements so as to enable them to benefit more from such agreements

Commodities and export diversification

30. Diversification not only broadens the scope for employment creation and poverty reduction, but it also increases a country's economic resilience to external shocks, thereby making income more stable and predictable. It can also promote technological advance and efficiency, boost labour productivity and incomes. Most importantly, successful export diversification is both indicative of and conducive to technological upgrading and knowledge acquisition.
31. For LDCs, dynamic gains and poverty reduction can also accrue, particularly from other non-traditional exports such as horticulture, fishing, and tourism. There is also considerable scope for many LDCs to join the group of successful agricultural commodity exporters in speciality and niche markets. However, most of LDC exports face intense competition and must satisfy the demanding quality and delivery schedules of developed-country markets. Development and trading partners of LDCs should provide technical and financial assistance to LDCs to help them meet safety requirements of consumers and industries. They should also make efforts to harmonize their national standards with those agreed at the international level.
32. LDCs can also take much greater advantage of their traditional commodity exports, both for minerals and agricultural commodities, if credible domestic and international agencies of restraint on rent-seeking can be instituted. Presently rising commodity and fuel prices are an opportunity for some LDCs to seize.
33. The key trade policy challenge in commodity dependent LDCs should be to upgrade their primary commodity sector coupled with a vigorous export promotion strategy to exploit dynamically changing comparative advantages, which can be part of a strategy of diversification into exports of labour intensive manufactures.
34. The global tourism industry is also highly competitive and a successful country must pass the market test of attracting tourists through provision of a quality product that encompasses transport services, accommodations, attractions, and security. Office services such as call centers and data processing are another promising but so far largely untapped area of potential comparative advantage for some LDCs.
35. UNCTAD should strengthen its work on commodities in cooperation, in particular, with the Common Fund for Commodities, the International Trade Centre UNCTAD/WTO, and other relevant bodies in: improving access to markets and reliability of supply, enhancing diversification and value addition, improving the competitiveness of commodities, strengthening the market chain and market structures and ensuring the effective participation of all stakeholders.

Sub-theme 3: Enhancing the enabling environment at all levels to strengthen productive capacity, trade and investment: mobilizing resources and harnessing knowledge for development

Challenges for LDCs

36. Developing productive capacities is key to economic and export diversification, sustained economic growth and lasting poverty reduction in LDCs. However, building productive capacities poses enormous challenges to the LDCs, mainly due to lack of adequate development finance, low savings and investment rates, low level of technological development, insufficient managerial skills and lack of skilled manpower, the confluence of which undermines their international competitiveness.

37. Moreover, most LDCs are either landlocked or small island developing states. Such geographical limitations mean exorbitant transport and transit costs for exports and imports, which further erode their capacity to trade and their ability to compete internationally. It is unlikely for LDCs to attain sustained and accelerated economic growth without structural transformation accompanied by the development of productive capacities for diversification and international competitiveness.

Actions and support measures required at all levels

38. LDCs with the support of the international community, particularly donors should make efforts to convert the challenges of landlockedness into opportunities by expanding and enhancing regional integration and by modernizing their transit transport infrastructure including through the use of Information and Communications Technologies (ICTs).
39. The overall lack of structural change and very slow rate of productivity growth in the LDCs as a group is the result of slow technological learning and a lack of innovation in their economies. There should be an enabling environment for private-sector-led growth with particular attention to the nature of the domestic firms, domestic financial systems and domestic knowledge systems. Success in the development of productive capacities depends on the existence of firms which are capable of investing, learning and innovating.
40. Getting infrastructure, technology and knowledge to LDCs and their people requires addressing multiple challenges at national, regional and international levels. At the national level, LDCs should attempt to put in place appropriate policies that alleviate problems of assets deprivation, through public support and a range of institutional and participatory approach. However, the provision of social and economic infrastructure including transport, telecommunication, schools, health services and electricity particularly to rural areas requires the support of their development partners.

Mobilizing resources for development

41. In the short and medium-term, the least developed countries and other structurally vulnerable economies will continue to rely more heavily on external resource flows mainly in the form of ODA and other grants to finance their development needs including enhancing productive capacities than on domestically generated resources and private capital flows.
42. Development partners (donor countries) - that have not done so - should endeavour to make additional efforts to meet the special ODA targets of 0.15% to 0.2% of their respective GNI to the LDCs by 2010. Aid conditionalities must not restrict policy choices in recipient countries. In the framework of international support measures to LDCs, there should also be a rebalancing of priorities between social sector development and production-related issues, with greater emphasis on the latter.
43. Development aid should also be coordinated, made predictable and linked to purposes that will contribute directly to the growth and development of LDCs. In this context, a significant improvement in the approach to aid policies is highly desirable if LDCs are to achieve greater ownership of public expenditure. This implies adherence to the internationally adopted Declarations of Rome (2003) and Paris (2005) on Aid Effectiveness: Ownership, Harmonisation, Alignment, Results and Mutual Accountability, which are increasingly regarded as important factors for the legitimacy of national development plans. Donor countries who have not signed to the Paris Declaration are encouraged to adopt similar measures
44. On their part, LDCs should demonstrate a commitment to sound development strategies and to the effective and purposeful mobilization and use of domestic resources. This should be accompanied by improved political, economic and corporate governance, free and fair elections, respect for human rights and freedom of expression, devolution of political power through political or economic decentralization.

45. LDCs should also put in place effective social policies so as to ensure that improved growth performance is translated into pro-poor growth and that the benefits from growth are equally redistributed to the poor and vulnerable sections of society. Too often in the past, economic growth has failed to 'trickle down' to the poor in the LDCs. Pro-poor growth also needs to be underpinned by improvements in the quality of governance, through greater transparency and accountability in public policy.
46. Foreign Direct Investment and other forms of technology transfer are crucial. LDCs have been actively pursing policies aimed at attracting and benefiting from FDI as a means of acquiring capital and technology, providing employment and export opportunities. Similar efforts should be made to enhance the role and contribution of domestic investment so that the crowding-out effect on domestic producers of goods and services could be avoided. Donors can also play a catalytic role through technical assistance and financing of infrastructure.
47. In the light of the growing economic importance to a number of LDCs of remittances from nationals living and working abroad, there is a need for greater and coordinated efforts by the international community to promote channels, mechanisms and international policies to reduce the transaction costs that hamper the use of remittances as a source of development financing in relevant countries. Intensifying or redirecting remittances towards productive investment schemes should be seen as a desirable policy objective.

Sub-theme 4: Strengthening UNCTAD; enhancing its development role, impact and institutional effectiveness.

48. For LDCs UNCTAD has an important role to play and through its research and policy analysis functions it should continue to address the development challenges facing them. This should, particularly contribute to improvements in the substantive content of national development policies and strategies as well as in international support measures for LDCs so as to ensure a more sustained growth and development .
49. UNCTAD should strengthen its policy analysis and consensus building activities in favour of LDCs. This should be complemented with financial and technical support to ensure effective participation of LDC delegations in major UNCTAD Conferences and intergovernmental meetings.
50. UNCTAD should also put in place a vibrant and meaningful strategy to reach-out top policymakers, research and academic institutions, private sector actors and civil society organisations in LDCs. This is will enable it to serve as a forum for dialogue and networking aimed at improving the substantive content of national policies and policymaking capacities in LDCs. There should be well structured and regular interaction between the UNCTAD secretariat and the national and /or regional institutions particularly in conceptualizing the research work, in integrating the national and regional perspectives as well as in disseminating the final products of the research work in the least developed countries.
51. UNCTAD should design and develop technical cooperation and capacity building activities for LDCs, drawing from the findings of its research and policy analysis function and implement them according to the LDCs needs and priorities. This will enable it to contribute effectively to institutional and technical capacity building as well as human resources development efforts of LDCs and maximize the developmental impact of such activities.

52. UNCTAD's capacity-building and technical cooperation activities in LDCs need to be supported by predictable and sound funding.. Therefore UNCTAD should make further efforts to cluster its various technical cooperation activities including developing multi- donor funded and multi-year

programmes. This will contribute to greater continuity and sustainability of human resources development and institution building in LDCs.

53. UNCTAD should assist LDCs in building their domestic statistical capacities including in developing database on potential export opportunities and markets information, particularly for their trade in goods and services.

54. The UNCTAD-LDC Trust Fund remains an important vehicle for initiating, designing and implementing technical cooperation and capacity building activities in LDCs. There is an urgent need for the regular replenishment of the LDC- Trust Fund including diversifying the sources of funding, as only a few donors have made contributions to it so far.

55. UNCTAD, with the support of Member States should also design a methodological framework to track, evaluate and assess the substantive impact of its policy and research work as well as the technical cooperation and capacity-building activities especially at the country and regional levels and report regularly to the Trade and Development Board.

56. The Secretary - General of UNCTAD has already taken an important and encouraging step in the right direction in clustering and strengthening the work of the Organization on Africa, LDCs and Special Programmes. He is encouraged, with the support of Member States, to strengthen further the Division of Africa, LDCs and Special Programmes by allocating adequate human and financial resources to enable it discharge fully its duties and functions.