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EXPORT DIVERSIFICATION IN LOW-INCOME COUNTRIES: AN INTERNATIONAL CHALLENGE AFTER DOHA

by

Federico Bonaglia and Kiichiro Fukasaku

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PREFACE

The Doha and Monterrey processes bear witness to the emerging global partnership between OECD and developing countries. The hallmarks of this partnership are a more intense co-operation based on national development strategies, the fuller integration of developing countries into the rule-based global trading system and an increased effort by OECD countries to help achieve the Millennium Development Goals. While progress has been made in all of these areas, more work needs to be done to address the specific interests and concerns of developing countries, especially the least developed among them.

Export diversification is one of these specific interests and concerns. Developing countries are heavily dependent on commodity exports and are therefore vulnerable to external shocks. In order to stabilise export earnings and foster income growth, these countries are seeking to increase the variety of their export baskets. According to this study, the results so far are mixed: export diversification continues to pose a major challenge for many low-income countries and especially the poorest. The Doha Development Agenda explicitly recognises this challenge and urges the international community to take concrete action to ensure meaningful market access and provide trade-related technical assistance and capacity building.

Identification of the specific needs in building trade capacity is best initiated by the country requiring that help. Externally-funded initiatives can support this process, but cannot be a substitute for a national trade strategy, the credibility of which is founded on a realistic assessment of the trade potential and major obstacles to be overcome.

The authors argue that the traditional strategy of export promotion, one which focuses on the international marketing of final goods, is no longer appropriate. Taking concrete examples from Africa, they recommended that trade and investment support organisations be revamped through increased engagement by the private sector and other relevant stakeholders. This would help tackle head-on major bottlenecks to international business development. Yet, the “capacity deficits” are so large in many low-income countries that continued international support for well-targeted capacity building programmes is indispensable.

Prepared under the Centre’s current programme of work on “Trade, Competitiveness and Adaptive Capacity”, this study makes an important contribution to the better understanding of one of the key international challenges post-Doha.

Louka Katseli
Director
OECD Development Centre
23 June 2003

RÉSUMÉ

Les principaux problèmes liés à la dépendance vis-à-vis des produits de base et à la diversification des exportations dans les pays à faibles revenus sont abordés dans ce Document technique. Contrairement à une opinion largement répandue, les ressources naturelles ne sont pas nécessairement une “tare” — elles ne condamnent pas les pays pauvres au sous-développement, mais peuvent au contraire constituer la base d’une croissance durable tirée par les exportations. Les secteurs liés aux ressources naturelles disposent d’un potentiel de diversification à l’exportation. Il ressort des données sur les échanges de l’OCDE que les voies de la diversification sont nombreuses et variées, notamment les activités de transformation des produits primaires et les activités manufacturières à base de ressources naturelles. Toutefois, ces possibilités ne sont pas exploitées dans de nombreux pays à faibles revenus. En effet, la diversification des exportations est un processus lent, qui doit être appuyé par une stratégie cohérente et adaptée caractérisée par la combinaison d’une vision à long terme, d’une coordination et d’une gestion des intérêts concurrents. De plus, l’étude des services de soutien aux échanges dans deux pays africains met en évidence le décalage entre les besoins du secteur privé et les services qui leur sont fournis, ainsi que les limites du développement institutionnel d’un réseau d’appui aux échanges et à l’investissement. Les leçons que l’on peut tirer de cette analyse en matière de renforcement des capacités commerciales sont importantes non seulement pour les pays d’Afrique, mais aussi pour d’autres pays à faibles revenus.

SUMMARY

This paper discusses major policy issues related to commodity dependence and export diversification in low-income countries. Contrary to some widely-held view, it argues that natural resources are not necessarily a “curse” — that they do not condemn low-income countries to underdevelopment but can provide rather a basis for sustained export-led growth. Natural resource-based sectors have potential for export diversification. The OECD “mirror” trade data suggest that many different routes to diversification exist, including resource-based manufacturing and processing of primary products. However, these opportunities are not being exploited in many low-income countries. This is because export diversification is typically a slow process, and this process needs to be sustained by an appropriate and coherent strategy, characterised by a combination of vision, co-ordination and management of conflicting interests. Moreover, the analysis of trade support services in two African countries points to a mismatch between private sector needs and the services available to them as well as to a limited institutional development of the trade and investment support network. Though important to Africa, lessons for trade capacity building are also relevant for other low-income countries too.

I. INTRODUCTION

Policy makers in low-income countries are concerned by the economic and political risk associated with heavy dependence on commodity exports. This concern stems from a widely held view that the high concentration of exports on primary commodities and natural resources can have detrimental effects on a country's growth prospects¹. In other words, resource-rich economies would grow slower than others, as if natural resources were a "curse". World demand for primary commodities has some unfavourable characteristics that can lower the income accruing to commodity-exporting countries. Supply-side features also have the potential to hamper growth: the difficulties in establishing linkages with the rest of the economy and creating opportunities for skill and technological improvement; the risk of causing excessive real exchange-rate overvaluation; and the possibility of inducing rent-seeking activities. Besides, it has been argued that resource wealth increases the likelihood of civil wars, favours authoritarian rule, and worsens income inequality². Hence, diversification to non-traditional, manufactured goods has been considered as a primary goal of national development strategies in many low-income countries.

While there is some truth in these arguments, the "resource curse" view should be taken with a pinch of salt. For one thing, the historical experience of several resource-rich OECD countries suggests that resource-based activities can sustain growth over long periods. For another, export diversification has in practice taken different forms in different countries, though some have been more successful than others. In a nutshell, natural resources are not necessarily a "curse" condemning low-income countries to underdevelopment. There is considerable potential for export diversification in both low-skill and resource-based manufacturing. Yet, as this paper will highlight, it remains a major challenge for many low-income countries — in Africa in particular — to realise this potential. These countries must use (rather than "sit on") their natural wealth to build new areas of competitive advantage in non-traditional products. The traditional view of export promotion often taken by public agencies dealing only with the overseas marketing of existing products is no longer appropriate for this task. They are not able to tackle in a comprehensive manner the inter-linkages of multiple trade challenges, such as the need for importing essential materials at world prices to facilitate export diversification, the need for enhancing the ability of firms to meet price and quality requirements of the global supply chains, the need for building the legal and physical infrastructures conducive to international business development, and so on. The international technical assistance currently being provided should help them to address these supply-side constraints.

Indeed, the post-Doha and post-Monterrey initiatives together provide a unique window of opportunity for both donor and partner countries to work together to this effect.

The Doha Ministerial Declaration, for instance, emphasises the role of trade-related technical assistance and capacity building (hereafter “trade capacity building” or TCB) to help developing countries achieve effective participation in the rules-based multilateral trading system and reap the full benefits of globalisation (see Box 1). Both bilateral donors and multilateral organisations have already tackled one aspect of TCB, namely “capacity to negotiate” with trade partners. This is a short-term (and even immediate) goal for many developing members in the WTO. Although an adequate provision of such technical assistance is important in its own right, this initiative must be supplemented by more concrete steps needed to improve, on the one hand, “capacity to implement” WTO rules and, on the other, “capacity to compete” in the international market. This is a longer-term goal of TCB and is of particular importance for the least-developed countries (LDCs) in their efforts to stimulate trade and investment flows and diversify exports. More specifically, the Ministerial Declaration states:

“[T]he integration of the LDCs into the multilateral trading system requires meaningful market access, support for the diversification of their production and export base, and trade-related technical assistance and capacity building” (paragraph 42).

On the question of market access, WTO Ministers have committed themselves to the “objective of duty-free, quota-free market access for products originating from LDCs” (*Ibid.*)³. They have also endorsed the Integrated Framework for Trade-Related Technical Assistance to Least-Developed Countries as a “viable model for LDCs’ trade development” with priority attached to addressing the “supply-side constraints of LDCs” (paragraph 43). As well as for the LDCs, such initiatives seem to be equally important for many low-income countries.

Box 1. What does Trade Capacity Building Mean in Practice?

Trade capacity building encompasses a broad range of activities aimed at enabling partner countries to participate effectively in the global trading system and helping them exploit their comparative advantage to the fullest extent. In an effort to identify best practices in the field of trade-related technical assistance, the donor community has adopted a set of Guidelines, which define TCB as a range of interconnected activities undertaken by donors and partner countries with the aim of enhancing the capabilities of the partner country’s policy makers, enterprises and civil society actors in three areas:

- formulating and implementing a trade strategy;
- strengthening policies and institutions designed to increase the volume and value-added of export production;
- enhancing participation in the rule making that shapes international trade.

The *Guidelines on Strengthening Trade Capacity for Development* have been tested and supported by several international and regional workshops with partner countries and constitute the basis for donors’ activities and data collection for the Doha Development Agenda Trade-Related Technical Assistance and Capacity Building Database (available on line at the address <http://tcbdb.wto.org/>).

Source : Adapted from OECD (2001).

This paper reviews and discusses major policy issues related to commodity dependence and export diversification in low-income countries. The rest of the paper is organised as follows. Section II takes a critical look at the recent literature on commodity dependence and economic development. Based on OECD “mirror” trade data, Section III presents statistical evidence on the degree of commodity dependence and export diversification in a selected group of 98 developing countries. Section IV reviews several successful experiences of export diversification and identifies some common features explaining these outcomes. In so doing, this Section focuses on the role of trade support services and institutions in Africa, which is of critical importance in overcoming barriers to trade. This draws upon the main findings of three case studies — Ethiopia, Kenya and Mauritius — on the supply and demand of such services (Bonaglia and Fukasaku, 2002). Section V concludes and discusses lessons for TCB.

II. COMMODITY DEPENDENCE AND SUSTAINABLE ECONOMIC DEVELOPMENT

Commodity-dependent economies are deemed to have lower growth prospects, because of both unfavourable characteristics of world demand for their exports and negative features of natural resource extraction and production. Furthermore, natural resource abundance may have detrimental effects on institution building, which in turn would impede development. The “paradox of impoverishing abundance” is generally referred to as “resource curse” in the literature⁴. On the demand side, the low income elasticity of world demand for primary commodities would lead to falling export revenues, a situation further aggravated by historically declining terms-of-trade⁵. On the supply side, the combined effect of lower skill and technology contents of commodity production and its negligible linkages with the rest of the economy would result in lower growth spillovers. Moreover, a resource boom could divert resources away from the manufacturing sector and, just as would a wealth shock, lead the real exchange rate to appreciate, thereby worsening international competitiveness — the so-called Dutch disease. Finally, natural resource-abundant countries would have a weaker incentive to industrialise, since they can easily earn the foreign exchange needed to finance their imports without industrialising. And when they do industrialise, they would specialise in physical capital-intensive products, with potential negative consequences on human capital development and wage inequality⁶.

The failure to industrialise in many resource-rich developing countries and a well-documented correlation between commodity dependence and slower growth rates have recently stirred a debate among academic researchers and policy makers. First, standard cross-section growth regressions lend support to the “resource curse” view. For example, Sachs and Warner (2001) find a statistically significant inverse association between resource-intensity — as measured by the share of primary commodity exports in GDP in 1970 — and growth, after controlling for other important determinants of economic performance. Gylfason (2001) finds that three different measures of education are all inversely related to natural resource abundance and suggests that resource wealth can actually weaken the incentive to accumulate human capital. Isham *et al.* (2002) argue that different export structures create different institutional capacities to manage shocks, since all natural resources are not the same. Countries that are abundant in “point-source” natural resources (e.g. oil or diamonds) tend to develop weaker institutions (and hence are more exposed to shocks) than those rich in “diffuse” natural resources (e.g. fertile land).

Second, according to standard Heckscher-Ohlin trade theory, a country’s trade structure reflects its comparative advantage, which is in turn determined by the relative endowment of production factors (land, labour, skill and capital). The relative abundance

of land (per worker) and scarcity of skill (per worker) would explain why African countries have failed to specialise in manufactured exports, in contrast to the skill-abundant and land-scarce East Asian economies. This is not a mere intellectual curiosity. Since some endowments are almost fixed, while others can be altered only very slowly (e.g. the stock of human capital), a country's relative factor endowment and hence comparative advantage are unlikely to change over the short run. Wood and Mayer (1998) thus argue that Africa cannot follow a development path based on manufactured exports and should rather improve the volume and quality of primary exports, processed and unprocessed.

Other recent studies, however, cast doubt on the foundation of the "resource curse" view, mostly along three lines of analysis:

- Historical evidence from several natural resource-rich OECD countries shows that resource-based activities can lead growth over long periods (Davis, 1995; Wright, 2001; Wright and Czelusta, 2002; Blomström and Kokko, 2003).
- Successful cases in non-OECD countries also point to the existence of a broad array of policy options for encouraging export diversification and reducing dependence on primary commodities (Buitelaar, 2001; Fisher, 2001; and Helleiner, 2002) as well as making natural resources working for the good of the country and encouraging the development of new export sectors (Fisher, 2001).
- Econometric misspecification: resource pessimists miss the point by focusing on too short a time span and by using inappropriate econometric techniques. The negative impact of natural resources on growth would disappear, once a longer time span is considered and the potential for omitted variables and endogeneity is taken into account in the estimation procedure (Lederman and Maloney, 2002)⁷.

These empirical studies, though not fully conclusive, indicate that natural resources can work for the good of a country. Moreover, besides traditional endowments, other important factors such as trade policy, infrastructure, macroeconomic (in)stability and the quality of institutions contribute to shaping a country's trade structure. The development of manufactured exports, in particular, depends critically on access to intermediate inputs, real exchange rates and transaction costs (Fosu *et al.*, 2001)⁸.

Three broad conclusions may be drawn from this brief review of the recent literature. Firstly, natural resources are not necessarily a "curse". Development failures exist among both resource-rich and resource-poor countries; however, a resource-rich country able to manage its own wealth has certainly more instruments to perform better and invest more than a resource-poor one. The crux of the matter is whether these countries build on what they have or sit on their wealth.

Secondly, what is detrimental to growth is not the dependence on natural resources *per se*, but rather the high concentration of exports subject to large price swings (Lederman and Maloney, 2002). Natural resource endowment is not destiny. Other endowments, such as knowledge, quality of institutions and infrastructure, are crucial in determining trade volumes and variety. Therefore, resource-rich countries can develop and foster new areas of competitive advantage by designing and implementing a sound strategy for export diversification (see Section IV for further discussion).

Thirdly, in pursuing an export diversification strategy, countries rich in natural resources should not ignore their wealth but rather use it to build new areas of

competitive advantage. Resource-based sectors can be a source of knowledge and technological advancement (World Bank, 2002), as exemplified by the historical experience of both OECD (e.g. Australia, Canada, Scandinavia and United States) and non-OECD economies (e.g. Brazil, Chile and Uruguay as well as several ASEAN countries).

Before closing this section, some comments may be in order regarding the long-term, downward price trend in primary commodities relative to manufactures (the so-called Prebisch-Singer hypothesis). For sure, the negative terms of trade effect worsens growth prospects, because a loss of resources and a tightening of foreign exchange constraints wreak havoc on investment and productivity⁹. Volatility and persistence of commodity price shocks appear to be of even greater concern than this long-term downward trend. According to Cashin and McDermott (2002), real commodity prices have declined by about 1 per cent per year over the last 140 years, but this has not been a smooth process, with prices sometimes changing by as much as 50 per cent in a single year.

That commodity prices are variable is not by itself necessarily detrimental to growth. On the one hand, negative price shocks actually benefit net importing countries of food and oil. Price volatility can also provide producing countries with an incentive to shift resources to most profitable activities. On the other hand, positive price shocks both over the long swings and during shorter periods are likely to cause high economic growth in commodity-exporting countries. Yet, the experience of commodity booms in the late 1970s demonstrates that the government whose role is to “smooth out” these impacts often found it difficult to achieve this objective¹⁰.

Many commodity-dependent countries, especially in Africa, but also in Latin America, failed to seize the growth opportunities arising from positive price shocks, because windfall gains were largely wasted in unproductive investment projects in their attempts to industrialise their economies through import-substitution strategies. The 1970s’ boom in commodity prices led developing countries to use them as “collateral” for debt (Manzano and Rigobon, 2001). When the prices started to fall at the end of the 1970s, governments assumed that the negative shock was short-lived and accumulated additional debt. In the 1980s, these countries were left with a large amount of debts and a decline in foreign resource flows to finance them. This situation is particularly worrisome for LDCs, as they are in general more commodity-dependent than other developing countries. According to the UNCTAD, external indebtedness and commodity dependence are integral elements of the poverty trap in which LDCs are caught¹¹. It is therefore natural that these countries should seek to increase the variety of their export baskets in order to stabilise export earnings and foster income growth¹². The next section will review how much low-income countries have managed to diversify their exports.

III. WHAT OECD “MIRROR” TRADE DATA TELL ABOUT DIVERSIFICATION

This section summarises information available on the degree of commodity dependence and export diversification in a selected group of 98 developing countries over a sufficiently long period (1966-2000). The 98 countries are comprised of 52 currently low-income countries (based on the World Bank definition) and on other 46 countries classified as “developing” at the beginning of the 1970s for the sake of comparison. These selected countries are grouped into four geographical regions: Asia; Latin America and Caribbean; Middle East and North Africa; and, sub-Saharan Africa. Due to the shortcomings of the trade reporting system in many developing countries in the early years, OECD *import* statistics are used to compare the *export* structure (and its changes over time) of partner countries. To make this exercise consistent throughout the period, the aggregate import value of 23 high-income OECD countries is taken to represent total merchandise exports of individual countries under consideration¹³. In addition, the merchandise imports of OECD high-income countries are classified into three major categories: broad primary products, low-skill manufactures and high-skill manufactures. Broad primary products are sub-divided into unprocessed and processed products. Further details are found in Annex about the construction of this “mirror” trade data, together with a full list of 98 countries (Annex Table).

According to the IMF Direction of Trade Statistics (CD-ROM 2002), the 23 high-income OECD countries received as a group roughly 60 per cent of total merchandise exports of these 98 countries over the period of 1996-2000. The high-income OECD countries constitute the single most important export market for each of the four developing regions, though there are larger differences among countries *within* the same region than between regions.

The methodology adopted in this section excludes so-called “South-South” trade and thus distorts the true picture of commodity dependence and export diversification. Since the 1970s, Southern countries have concluded a variety of preferential trade arrangements among themselves in order to foster South-South trade and attract foreign direct investment from the North. Despite that, Northern markets remain the most attractive for Southern exporters, so that a rise in market shares in the North can be seen as an important yardstick for policy success — with caution, as will be noted later in this section.

Table 1 presents summary statistics on the export structure of low-income and other developing countries by region¹⁴. Three major features are worth noting. Firstly, commodity dependence was a widespread phenomenon in all developing regions at the end of the 1960s. The average share of primary products was roughly 90 per cent of total

merchandise exports from these countries. There was little significant difference between 47 of the countries currently classified as low-income and other developing countries at that time in terms of the degree of commodity dependence in exports. Asia was the only region where manufactures already accounted for some 25 per cent of total merchandise exports before the 1970s. The Annex Table also indicates that only four of the 11 countries whose commodity dependence was below 75 per cent were outside Asia (viz. Bahamas, Barbados, Haiti and Malta).

Secondly, thirty years later, broad primary products still constitute the majority of merchandise exports in all developing regions except Asia. In particular, these products accounted for more than 90 per cent of merchandise exports from the majority of the partner countries in sub-Saharan Africa (see Annex Table), which suggests that very little change in trade structure has taken place in this region. By contrast, major structural transformation has occurred in Asia and, to a lesser extent, in the MENA and Latin America and Caribbean regions.

Thirdly, Asia is the *only* region where export diversification was accompanied by a corresponding rise in its market share in the high-income OECD countries, while all other regions lost theirs. The situation is particularly worrisome for Africa. In fact, with a combined population of almost 650 million, the 38 African countries account for 1.5 per cent of high-income OECD imports, roughly as much as Malaysia. As a result, the aggregate market share of all 93 countries increased only moderately to 22 per cent in 1996-2000, 5 percentage points higher than the 1966-70 level.

Table 1. **Commodity Dependence by Region**, 1966-70 and 1996-2000
Share of broad primary products in total exports (five-year, simple averages, percentage)

		Mean	Median	Minimum	Maximum	Market share
Asia (19)	1966-1970	76	86	5	99	4.5
	1996-2000	22	14	4	64	13.4
Latin America and Caribbean (26)	1966-1970	92	96	71	99	6.6
	1996-2000	63	61	15	96	5.8
Middle East and North Africa (10)	1966-1970	85	91	32	98	2.1
	1996-2000	51	44	4	95	1.0
Sub-Saharan Africa (38)	1966-1970	97	99	86	100	3.9
	1996-2000	86	92	29	100	1.5
Overall (93)	1966-1970	90	97	5	100	17.1
	1996-2000	63	73	4	100	21.8
Low Income (47)	1966-1970	93	98	46	100	4.7
	1996-2000	74	88	4	100	3.0

Note: The number of partner countries under consideration is given in parenthesis. "Market share" is the cumulative share of the 23 high-income OECD countries' imports from the countries belonging to the specified region or group in proportion to their imports from the world. Five low-income countries are excluded from this table, due to the lack of trade data between 1966 and 1970. See Annex Table for a full list of the 98 partner countries.

Source: Authors' own calculation based on OECD *Foreign Trade Statistics Database* (2002).

The Annex Table presents detailed information on the structural changes that individual developing countries have experienced on the export front. It shows that only a limited number of countries managed to increase their market shares — most notably China — though most of them started from a very low level. In general, a rise in market share is associated with diversification to manufactured exports. For the group as a whole, the share of manufactures in total merchandise exports increased from 11 to 37 per cent during the period examined. The overall picture, however, masks large differences across countries. In other words, diversification does not always deliver “export success”, as far as one can judge from a rise in market shares in high-income OECD countries.

Table 2 highlights this point. In the case of China and several ASEAN countries, diversification and export growth have gone hand in hand. These economies have been successful in promoting low-skill manufactured exports (e.g. textiles, clothing and simple electronic parts and components) since the second half of the 1980s, and this transformation has continued apace over the last decade. At the same time, these countries have successfully developed resource-based export activities, such as aquaculture and industrial tree plantations¹⁵. In Latin America and the Caribbean, diversification was accompanied by a fall in market shares in high-income OECD countries, with a few notable exceptions. Mexico and to a lesser extent Costa Rica and the Dominican Republic have followed a pattern of industrialisation similar to that of Asian countries, moving away from primary commodities to manufacturing. Other countries, such as Chile and Colombia, have increased product variety by exporting more processed primary products. In the Mediterranean region — despite some noticeable examples of diversification — market shares fell in all countries with the exception of Malta and Tunisia.

Table 2. **Export Diversification and Changes in Market Shares** (1966-70 and 1996-2000)

	Increased share in OECD market	Decreased share in OECD market
Share of manufactured products in total merchandise exports higher than 50 per cent by 1996-2000	<i>Cambodia</i>	Barbados
	China	Cyprus
	Costa Rica	El Salvador
	Dominican Republic	<i>Haiti</i>
	<i>Indonesia</i>	Honduras
	<i>Laos</i>	<i>India</i>
	Malaysia	Lebanon
	Mauritius	Liberia
	Mexico	Morocco
	Philippines	<i>Myanmar</i>
	Singapore	<i>Pakistan</i>
	Thailand	Sri Lanka
	Tunisia	
	<i>Viet Nam</i>	
Share of manufactured products in total merchandise exports already higher than 50 per cent in 1966-1970	<i>Bangladesh</i>	Hong Kong, China
	Korea Republic	
	<i>Lesotho</i>	
	Malta	
	<i>Nepal</i>	

Source: Annex Table. Country names in italics indicate low-income countries today.

In the majority of sub-Saharan African countries, diversification has yet to occur. At the end of the 1990s, only nine of the 41 African countries listed in Annex Table had at least 25 per cent of their exports coming from the manufacturing sector. Among these countries, the case of Mauritius deserves particular attention, since this country has managed to develop a thriving export-oriented manufacturing sector, starting from a sugar-dependent economy. During the last decade, Mauritius has begun to invest directly in Madagascar's clothing sector, favouring diversification of this country's exports. Lesotho offers another example. This country — the least dependent on primary commodities in sub-Saharan Africa — was already exporting manufactures at the end of the 1970s, by exploiting its geographical location to tranship South African products during the apartheid embargo. By the late 1990s, it had become a focus for foreign direct investment in the clothing sector. The country has taken advantage of trade privileges granted under the Multi-Fibre Arrangement (MFA) and the duty-free access provided under the *Africa Growth and Opportunity Act* (AGOA) initiative by the United States¹⁶.

A few words of caution may be in order regarding the interpretation of these results. For one thing, the lower level of diversification in the exports of Chile, Colombia and some other Latin American countries should be interpreted with care. This does not mean that these countries have failed to diversify their exports as much as other resource-rich countries discussed above; rather, they have followed a different pattern, rapidly expanding their resource-based and other manufactured exports within the regional Latin American market. For another, export diversification aims to reduce the risk associated with price swings and to develop new areas of competitive advantage. Despite their initial success of diversification, the merchandise exports of low-income countries, such as Cambodia, Laos and Lesotho, are highly concentrated in a narrow range of clothing, bolstered by the export quotas that have been put in place under the MFA. The dismantling of MFA quotas by the end of 2004 and the changes in the AGOA provisions pose a big challenge to these and other small exporters of clothing¹⁷. The full integration into the global economy of large, heavily populated countries, such as China and India, will dramatically change the international division of labour, affecting primarily those countries exporting inherently "footloose" manufactured products.

This analysis of export structures of low-income and other developing countries over the past three decades complements the literature review in the previous section and highlights the following points:

- Commodity pessimism is not always justified: diversification opportunities exist and new areas of competitive advantage can be developed;
- Export diversification is a slow process and still remains a major challenge for low-income countries, especially in Africa. In this continent, a less diversified export structure is aggravated by a marked reduction in their shares in the imports of high-income OECD countries;
- Diversification, however, does not necessarily deliver "export success" in terms of either higher market shares or reduced volatility/risk.

The last two points deserve particular attention. The historical experience of several resource-rich countries in Asia and Latin America indicates that when appropriate policies are in place (see the next section) low-skill manufacturing becomes a viable option for countries where human capital is not the major driver of comparative

advantage. However, diversification towards manufacturing is not the only possibility and, as mentioned, it does not come free of risk.

Instead of following the same route to development of low-skill manufacturing, a sensible strategy for today's resource-rich countries would be to pursue a different route to development of resource-based manufacturing and commodity processing, as well as trade in services. This is because organisational and technological developments have contributed dramatically to alter the production structure in these sectors. Global production sharing facilitates connections to international markets, more predictable demand and transfer of knowledge. As mentioned earlier, natural resource sectors, such as mining and forestry, are nowadays characterised by higher technology content and can encourage the development of upstream and downstream activities as well as generating spin-offs towards side sectors, such as services¹⁸.

In a similar vein, it is also a feasible option for many low-income, commodity-dependent countries to increase the efficiency of firms operating in the agricultural sector and to develop non-traditional primary exports, as the experience of the so called "Newly Agro-Industrialising Countries" shows (see Box 2 in the next section). Over the last two decades, significant technological advances in packaging and transportation and dramatic changes in the patterns of food consumption in OECD countries have opened up new opportunities for agricultural trade, with fresh food products becoming a significant part of global agro-food and fibre trade¹⁹. Processing of primary commodities (i.e. vertical diversification) and production of new types of commodities, such as "off-season" and "speciality fresh vegetables" or cut flowers (i.e. horizontal diversification), have already generated some successful stories in African countries with low labour costs and appropriate agro-ecological conditions. Therefore, these commodity-dependent countries should not ignore the opportunities that exist in primary commodity production, but at the same time need to implement a comprehensive strategy for diversification over the longer term.

IV. STRATEGIES FOR EXPORT DIVERSIFICATION RECONSIDERED

This section examines the long-standing policy discussions on export diversification from the perspective of policy makers seeking good practices and guidance. Despite more than a decade of policy reform and structural adjustment, the supply response has been weak in many of today's low-income countries. As seen in the preceding section, export diversification remains a major challenge for these countries, in particular those in Africa. While it is possible to point out different reasons for different contexts, some general comments may be in order.

First of all, it is now widely acknowledged that trade policy reform will not by itself be sufficient to deliver large supply responses in terms of expanding trade volume, increasing export varieties and attracting FDI inflows. For one thing, the direct impact of trade policy reform, such as the elimination of export taxes and the dismantling of marketing boards, can be undermined by the lack of progress in other reform areas. A case in point is Africa's poor infrastructure, which prevents local farmers from expanding production of raw materials for an export processing activity. For another, the reform process may be incomplete in the eyes of private investors, in the sense that the unfinished reform fails to provide an enabling environment for trade and investment promotion²⁰.

Secondly, despite a large body of literature, the debate still continues on the role of selective intervention in stimulating export growth and diversification²¹. This was possibly prompted by the World Bank (1993) publication on the development experience of East Asia's first- and second-tier "tiger economies". On the top of general adherence to the policy of "getting fundamentals right", these economies did adopt a wide range of selective measures (e.g. direct credit allocation, subsidies and other incentives and local-content requirements). Some argue that selective intervention policies can help firms to improve their export competitiveness, when these policies can solve co-ordination failures and provide facilities and services which have the nature of public goods (e.g. Rodrik, 1995). However, policy choices are highly context-specific, and it is extremely difficult, if not impossible, to disentangle the impact of different measures adopted. Moreover, a review of several successful countries suggests that there is no *unique* strategy for export diversification (Box 2).

Thirdly, it is vital to reduce transaction costs and improve local business conditions, in order for firms to be able to respond more quickly to emerging opportunities and the challenges arising from on-going policy reforms. This line of policy discussion takes a "business-oriented" approach and centres on the question of how the government can help create a pro-business environment. As will be clear at the end of this section, this task requires not only a general shift in policies, but also a fundamental change in the policy making process in many low-income countries.

Box 2. Export Diversification: Early Success Stories

Chile: the successful transformation of the Chilean economy rests upon the adoption of a coherent policy package which the private sector has helped to adopt. Three major lessons emerge from this experience. First, trade liberalisation was implemented in conjunction with appropriate fiscal and monetary policies to encourage investment and restructuring, as well as with industrial policies correcting for market failures and weaknesses in the private sector (e.g. dissemination of market information and financial support for R&D). Second, export diversification was placed under the overall development strategy to promote several strategic sectors for export markets (such as forestry and wood clusters) to attract FDI in export-oriented or science-based sectors, to promote regional trade integration, and to strengthen linkages between the resource-based sectors and the rest of the economy. Finally, private-public partnership was promoted to ensure the success of policy reform. The Chilean case is an example of how natural resource based sectors can sustain growth for long periods, while at the same time favouring vertical diversification and creating the knowledge base that can spur new exports.

Costa Rica: the gradual transition to an open trade regime minimised recessions and large-scale unemployment, while bolstering export growth (with an annual average rate of 14 per cent over the 1961-82 period). The active participation of private sector organisations to this reform process dramatically increased its effectiveness. Initially, emphasis was placed on competitive and stable exchange rates and direct subsidies to compensate for the anti-export bias, to promote traditional exports (defined as coffee, banana, beef and cocoa). As export diversification (from the mid-1980s onward) gathered momentum, tariffs were reduced and other distortions removed. Regional trade integration helped to tackle the limitations imposed by the small size of the internal market. Investment in science, technology and human resource development helped this process. Equally important was an active FDI policy to invite MNEs in certain targeted sectors, such as INTEL in electronics.

Malaysia and Thailand stand out as successful examples of both vertical and horizontal diversification. Both governments adopted a dual strategy to upgrade natural resource-based industries (such as palm oil and rubber products in Malaysia and agricultural and fish products in Thailand) and to encourage labour-intensive manufactured exports, most notably clothing and electronics. Agriculture played a key role in the industrialisation process, making these countries a successful example of Newly Agro-Industrialising Countries (NAIC). The development of traditional (e.g. rice and rubber) and high-value, export-orientated agriculture stimulated the growth of agro-industry. In the case of palm oil and rubber, Malaysia set up specialised agencies to promote production and upgrading, and used the proceeds of production and export taxes to finance research and development investments. Both countries established EPZs and licensed bonded warehouses as a means of stimulating manufactured exports and attracting foreign investment. FDI came mostly from neighbouring Asian countries (Japan and Asian NIEs). The development of natural resource-based sectors helped both countries to cope with the economic downturn after the mid-1990s, which affected manufactures exports most severely.

Sources: Adapted from Agosin (2002) and Fisher (2001) on Chile, Rodríguez (2002) on Costa Rica, Reinhardt (2000) on Malaysia and Thailand.

Finally, the discussion on how donors can help to build trade capacity must be placed in the broader policy context of export diversification. There is now an urgent need for designing and implementing an integrated approach to export development which considers the reduction of risk and transaction costs as a key element in achieving higher investment and productivity growth (World Bank, 2000, Elbadawi, 2001). Any serious “business plan” for trade promotion and export diversification must be based on a realistic assessment of a country’s position in the international division of labour, complemented by an analysis of how to develop new areas of competitive advantage. This cannot be done without an assessment of:

- External opportunities and constraints: how is world demand evolving? What are the most dynamic products? What are the entry conditions for these products in international markets? How are these products to be placed into global commodity chains? What is the governance structure of the commodity chain?
- Internal opportunities and constraints: what are the strengths and the weaknesses of the private sector? How are government policies affecting the private sector's ability to trade? How is the country placed in terms of producing the most dynamic export products and meeting the market entry conditions? Which interest groups are likely to consider themselves affected by a specific policy?

Three African examples provided in Box 3 are somewhat paradigmatic of the interaction of these multiple opportunities and constraints. Primary commodity processing has traditionally been considered an important area for export diversification in low-income countries²². However, many constraints, external and internal, still prevent producers from fully exploiting existing opportunities²³. External constraints include tariff escalation, strict sanitary and phytosanitary regulations and technical barriers to trade, as well as vertical integration of retailers that acts as a strategic barrier to entry. Domestic constraints are related to weaknesses of private firms and inadequacy of government policies, which reinforce external ones. For instance, successful experiences of agricultural export diversification suggest that diversification often follows the development of domestic markets. Many low-income countries are indeed already engaged in food processing for their domestic markets. Admittedly, breaking into the international market is more demanding than serving domestic consumers, especially in terms of meeting stringent entry conditions and satisfying final buyers' demand in a timely fashion. It often requires an investment in supply-chain management and in quality control, marketing and branding. In many cases, this is beyond the capabilities of individual producers. Fragmentation of producers and a low degree of reliability in terms of product supply are major obstacles to realising the untapped potential in exports of high-value food commodities²⁴.

Many low-income countries lack the human, institutional and financial resources for conducting such analyses and designing comprehensive export strategies. As shown in Section III, commodity dependence remains very high in African countries. However, few of these countries have an integrated national export strategy, and even fewer have one that works²⁵. Therefore, this is an area where targeted donor initiatives can play an important role, both in providing tools for assessing bottlenecks and exploiting opportunities, and in easing external constraints. While acknowledging the importance of market access and of understanding international trade rules, more attention should be paid to addressing domestic constraints to export development. In fact, a first step in building *capacity to trade competitively* is to identify key domestic barriers to international business development and to take measures to improve local conditions for business. These barriers include government policy constraints (e.g. the anti-export bias due to exchange rate misalignment and taxes on international trade), financial market constraints (e.g. limited provision of export credit and insurance), poor infrastructure and administrative constraints (e.g. high transport costs and red tapes), and limited trading knowledge (e.g. lack of information on foreign market structure, contact making and marketing). In this respect, trade support services (TSS) can play an important role in facilitating international business development by reducing transaction costs, improving learning processes and building the trade capacity of private firms²⁶.

Box 3. Export Diversification in Eastern Africa: Kenya, Mozambique, Uganda

Kenya has sought to diversify away from traditional commodities (i.e. tea and coffee) to processed products (such as preserved fruit and fish products), to the production of new types of niche products (such as “off-season” and “specialty fresh vegetables” or cut flowers) and to manufacturing (apparel, clothing accessories and leather products). Results have been mixed, however. While Kenya is now the largest African cut-flower grower and one of the biggest exporters of fresh horticultural produce, the country has been less successful in manufacturing. Notwithstanding initial positive achievements, the provision of incentives to export-oriented manufacturing firms failed to sustain export growth. Kenya had already emerged in the late 1960s as a supplier of “off-season” fruits and vegetables to the United Kingdom and then to other European markets. Besides the booming trade in fresh horticultural produce, Kenya started to develop cut-flower exports. This industry underwent a major transformation, thanks to foreign investment, in particular with the establishment of a Danish company which was granted attractive investment terms. The company brought in capital and expertise to generate considerable spin-offs. Several expatriate professionals left the company and started up their own small flower businesses. In the 1970s, the Horticultural Crops Development Authority managed an experimental programme to train smallholding farmers in flower cultivation and to organise their harvest for export. The great expansion of the sector in the 1980s increased the demand for technical assistance, which gave rise to a technical support cluster of specialised service suppliers. Cut-flower exports took-off in the 1990s in conjunction with significant reforms in import procedures, foreign exchange and air freight sectors, improvements in infrastructure and active investment promotion. Historically dependent on foreign capital and expertise, the industry has increasingly seen the emergence of Kenyan players, with significant levels of expertise, to the point that the country is now largely self-sufficient in in-house knowledge and provides business services to other African countries

Mozambique: The case of cashew nuts in Mozambique highlights the problems associated with promoting and sustaining commodity processing and the importance of avoiding the temptation of “quick fix” policies in the absence of a coherent strategy. Mozambican cashew nut processing was an early success story, thanks to the establishment of mechanised factories in the 1950s, which made the country the world’s leading exporter. After independence, factories were nationalised and, due to scarce managerial and technical resources, the industry declined rapidly. The government ban on exports of raw cashews at the end of the 1970s did not help to revive it, since equipment was obsolescent and competition from Brazil and India was mounting. The decade-long civil war also contributed to aggravating the situation by disrupting rural production and trade. The post-civil war period witnessed various attempts to reform and revamp the sector, culminating with the heated debate of the 1990s on the liberalisation of cashew marketing and exporting, which was supported by the World Bank. Advocates of the reform based their argument on the inefficient technology employed for processing and the favourable impact liberalisation would have had on farm-gate prices, thereby stimulating production and exports of raw nuts and eventually improving growers’ welfare. The upshot of this reform is that on one hand, the expected increase in cashew production for export and the induced income boost for the poor did not materialise; on the other, processing is now in disarray, as witnessed by the closure of almost all factories by 2001.

Uganda: the Lake Victoria fish industry exemplifies both opportunities and challenges with respect to commodity upgrading. Overall, this sector has experienced spectacular growth in recent years. Fishing activities have developed around the Lake since the 1990s, providing today some \$200 million per year in export earnings and employing around 200 thousand people. Until that time, large fish stocks were almost unexploited for commercial purposes. Only about a tenth of the fish population of the Lake was sold un-processed on the local market. During the 1990s, responding to an increase in the European demand for fresh water fish, a few Ugandan companies started processing and airlifted fresh Nile Perch in the form of fish fillets. As soon as the sector expanded, problems of quality and phytosanitary standards emerged, due to inadequate chilling equipment, as well as environmental concerns as a result of fish processing waste. Low yields (due to high wastage in fish filleting) and the 1999 EU ban on Ugandan imports due to suspected fish poisoning — leading to a 35 per cent decrease in exports — risked undermining the viability of the sector. The Uganda Fish Processors and Exporters Association (UFPEA) played a critical role in obtaining technical assistance from donors and establishing a reliable fish safety assurance system in compliance with EU standards. UFPEA members have directly invested more than \$100 million in the sector. The growth of the fresh fillet sector has spurred the development of side sectors — such as processing of wastage for producing animal feed and fertilisers — as well as downstream sectors — such as the packaging and freight and shipping companies — and upstream sectors with fishermen adapting their techniques to the new quality and organisational requirements set by the industry. The development of fish exports has also generated spillovers to other sectors, thanks to the improvement of cold storage and freight services. For instance, fish exporters joined forces with flower exporters’ ground-handling firms to bring down freight rates and improve freight services at Entebbe Airport.

Sources : Adapted from Glenday and Ndi (2000) and Thoen *et al.* (1999) on Kenya, Cramer (1999) on Mozambique, Dijkstra (2001) on Uganda.

The Role of Trade Support Services: Evidence from Firm Survey

Earlier studies indicate that exporters attach a high value to trade support services (TSS) as a key component of an export diversification strategy (Keesing and Singer, 1990; USAID, 1994; and International Trade Centre, 1997). Broadly defined, TSS include trade finance, general business services, telecommunication and transport services, and trade promotion and marketing services.

The Development Centre undertook three case studies to supplement the survey data collected by the ITC, in order to shed more light on the question of how firms in sub-Saharan Africa could improve their connection to international markets (Bonaglia and Fukasaku, 2002)²⁷. As already mentioned, commodity dependence is geographically concentrated in this continent, where the export of non-oil primary commodities — mostly unprocessed — continues to be the main source of foreign exchange earnings for the majority of the countries. Special attention was paid to the role of TSS as a facilitator of international trade activity, an area where evidence is scarce. These case studies analysed trade support policies and institutions in Ethiopia, Kenya and Mauritius, with two firm surveys conducted in Kenya (October 2000) and Ethiopia (December 2001) to evaluate the use of trade support services and the satisfaction with existing provision. Some policy lessons deserve particular attention.

Trade Support Services are Important but Not Widely Used

Findings from the two African firm surveys suggest that while the positive role of TSS is being acknowledged, their actual use has been very limited and firms are not very satisfied with the services that are currently provided. Trade finance and transport and communication emerged as the primary areas of concern for both firms and business associations²⁸. When looking at the actual use of these services, very little use is made of technical assistance and pre-export services. Many surveyed firms are characterised as “passive” and do not invest much in preparing for export.

The Delivery Mechanism is Not Working Well

Flaws on both the supply and demand sides of TSS partly explain the passive behaviour in export development. On the supply side, the provision of these services is still predominantly in hands of public trade promotion organisations, which appeared to be largely ineffective due to inadequate staffing and resources, conflicting competencies as well as political interference. Unfortunately, the emergence of private markets for business services has been rather slow and business associations often lack resources and acknowledgement from government. The use of in-house services as well as reliance on buyers and business partners is a very common feature in both countries, reinforcing the idea of inadequate supply. On the demand side, many exporting firms have not been willing or able to adjust their strategies to the increasingly liberalised and competitive business environment. Inward-looking attitudes developed under the import-

substitution policy regime still linger on. Finally, the availability of “captive markets” at home or in neighbouring countries has made less compelling for firms to adopt more active trade strategies. This seems to be especially the case for Kenyan firms with respect to the East African market.

Although both Ethiopia and Kenya have established public agencies responsible for provision of TSS, firms do not seem to rely much on them. Concerns regarding the capability of governments to understand and efficiently meet exporters’ needs frequently emerged during interviews. Many firms pointed to inefficiency and inflexibility of government services, political interference and high transaction costs as major sources of complaints. In both countries, exporters were of the opinion that only a handful of export promotion programmes were truly effective²⁹. Private providers were usually thought to be more efficient than existing public or semi-public agencies in charge of export promotion. The latter often lack the expertise and resources for tackling the issue of export competitiveness and sometimes carry out services that are or could be offered by private-sector organisations.

Participatory Governance is Key

The general lack of confidence in the public agencies’ services observed in Ethiopia and Kenya probably reflects the inadequate involvement of the private sector in policy design and implementation. Neither country has yet developed an institutionalised mechanism for representing the private sector with the government. This seems to be quite a pervasive feature in African countries³⁰. In this respect Mauritius is probably an exception. This country is characterised by having an effective governance system in national trade policy making, which has greatly contributed to the successful implementation of trade and investment promotion and the structural transformation of the economy. Its participatory approach to policy design and implementation has made it possible to build a national consensus on a clear and shared vision of development and to obtain broad-based support for the reforms needed to achieve it. The roots of this approach probably lie in the need to manage the cultural diversity characterising Mauritian society and to grant protection to minorities³¹.

Incentives and technical support play a key role in the export-oriented development strategy of this country, and firms make extensive use of the services provided by specialised public agencies, business organisations and private firms. Specialised public agencies are well funded, have highly professional staffs and enjoy high credibility with the private sector. Changes in the range of services provided are always decided upon on the basis of close consultations with exporters, with due consideration being given to the country’s development objectives. Public intervention does not “crowd out” private providers. On the contrary, public agencies step in where market solutions are not available and exporters are encouraged to source their services from private firms, for example through matching grants and cost-sharing schemes (Box 4).

Box 4. Trade and Investment Support Network in Mauritius

The Mauritian government initially took the lead in the provision of trade support services through public agencies, usually free of charge. As the private sector developed, service provision became more focused and based on cost-sharing schemes. At the same time, reflecting the emergence of private service providers, direct service provision was gradually replaced by matching grants. Today service provision is targeted to small firms and to the areas where private providers are not available. Some agencies (e.g. the Industrial and Vocational Training Board) have now given up direct provision of services and become regulatory bodies. The following lessons can be drawn from the experience of this small island economy:

- *Autonomy*: public agencies operate autonomously and have a strong private-sector orientation (for instance, through representatives on governing boards designated by the private sector);
- *Quality*: public agencies offer high quality services, which make them valuable to business;
- *Comprehensiveness*: support services tackle overall supply-side weaknesses, not just the final marketing stage;
- *Customer orientation*: service providers take into consideration the particular needs of the client, notably those of SMEs operating in labour-intensive sectors with large potential for employment creation;
- *Crowding-in*: public intervention does not monopolise service provision but helps to facilitate the development of a market for business services. In many cases, public agencies offer services only indirectly, outsourcing to private firms or allowing exporters to find their preferred providers on the market;
- *Flexibility*: the whole support network is constantly adapting to the changing needs and conditions of the economy through consultation with the private sector and civil society.

Source: adapted from Bonaglia and Fukasaku (2002), Chapter 5.

Finally, two words of caution are in order. First, conflict of interests may emerge in the area of TCB, so that the neutrality of external assistance should be transparently ensured for local ownership to be genuine. Donors must set up delivery mechanisms that ensure that assistance is provided according to recipient countries' interests (see Solignac Lecomte, 2003). Second, as noted earlier, export diversification is a slow process that needs to be sustained by an appropriate and coherent strategy, characterised by a combination of vision, co-ordination and management of conflicting interests. Sustainability requires that governments ensure the consistency of different policy instruments in the areas affecting export competitiveness (trade policy and exchange rate management in particular) as well as adequate involvement of the private sector and other relevant stakeholders in the national policy-making process.

V. LESSONS FOR TRADE CAPACITY BUILDING

This paper aims to inform policy discussions related to commodity dependence and export diversification in low-income countries. Both governments and companies in these countries are facing a daunting challenge, because of their economies' structural vulnerability and the vicious circle of low export revenues, low investment and low productivity in which they are caught.

Section II reviewed the risks associated with natural resource abundance and commodity dependence and stressed the importance of seeking export diversification. In so doing, this section emphasised the potential for natural resources to be a source of growth if properly managed. Based on historical OECD import data, Section III assessed the progress made in terms of export diversification among low-income and other developing countries during the past three decades. The data suggest that many different routes to diversification exist, including resource-based manufacturing and processing of primary products. However, these opportunities are far from been exploited in many low-income countries, especially in Africa. Based on this evidence, Section IV asked how governments of commodity-dependent countries can design effective strategies for export diversification and how donors can help them improve their capacity to trade. This section stressed the need for these governments to carefully evaluate opportunities for and constraints on export development, in close consultation with all relevant stakeholders. It also highlighted how internal and external constraints to export diversification are intertwined. In addressing the domestic dimension, the improvement of local conditions for business and the reduction of transaction costs emerged as critical elements. In this respect, adequate provision of TSS appeared as an important tool for overcoming supply-side bottlenecks. The analysis of provision, use and satisfaction with public TSS in two African countries pointed to a mismatch between private sector's needs and services actually provided and to a limited institutional development of the trade and investment support network. This mismatch stems from the lack of a well-functioning governance structure in trade policy formulation and implementation; this can severely undermine any attempt at improving trade capacity.

What are then the implications for TCB initiatives? A first lesson emerging from the above analysis is that an integrated approach to TCB should be adopted (as suggested, *inter alia*, by the DAC Guidelines). The approach should be integrated in scope, i.e. addressing both the supply-side and trade policy agendas of partner countries, and in delivery, i.e. setting up a co-ordinated mechanism to create synergies and use resources more efficiently. Co-ordination is also a key to adequately tackling the limited absorptive capacity that characterises trade-related organisations in recipient countries. In this respect, the experience of TCB initiatives should be shared more widely among neighbouring countries of the same region.

Second, in light of the specific needs of commodity-dependent countries, where the interplay between supply-side constraints and technical barriers to trade is particularly severe, TCB initiatives should provide them with practical tools to identify the supply-side bottlenecks hindering the development of higher value-added and less footloose export products and to design an export diversification strategy. Donors should help these countries to develop a more efficient trade and investment support network by sharing their expertise in these areas and by providing access to trade data and regulations. Experiences from the trade and investment support network in both OECD and non-OECD countries (such as Mauritius) can be extremely valuable to countries in need of reforming public agencies in charge of trade and investment promotion.

Third, since export diversification is a slow process and commodity-dependent countries are exposed to boom-and-bust commodity cycles, the government's effort at sustaining new export sectors can be disrupted by external shocks. The shortage of foreign exchange (in case of negative shocks) and the diversion of resources to boom sectors (in case of positive shocks) can be regarded as serious risks until a strong private sector is established in the emerging sectors. The donor community should therefore help governments to withstand such shocks and sustain their diversification strategies. Such help can include initiatives to facilitate the establishment of commodity risk-management instruments, as well as enhanced market access and specific programmes for fostering the development of new export sectors.

Fourth, as the analysis of the trade support services in Africa has highlighted, export development has been hampered by a deficient governance structure in national trade-policy making. The lack of involvement of non-governmental stakeholders in the policy formulation process not only reduces the effectiveness of and support for policies, but may also undermine their perceived legitimacy. TCB should therefore aim at strengthening the trade-policy dialogue, reinforcing business advocacy and civil society organisations and raising awareness on trade policy issues (e.g. university curricula, etc.). In many cases, concerns over the legitimacy of these organisations together with their severe resource constraints tend to reduce greatly their capacity to safeguard and promote the interests of their stakeholders. In order to tackle head-on major bottlenecks to international business development, trade and investment support organisations in Africa should be revamped through greater engagement of the private sector and other relevant stakeholders.

Fifth, donors should ensure neutrality when defining priorities for trade-related technical assistance and capacity building. Donors' support for TCB initiatives must also be made predictable. Otherwise TCB efforts cannot be sustained. One crucial question, which needs to be addressed, is how to operationalise a participatory approach to trade policy making and an effective delivery of assistance in countries with weak institutions (Solignac Lecomte, 2003).

Last but not least, TCB cannot be seen as a substitute for meaningful market access for low-income countries. In this respect, the trade and donor communities should work together to ensure that TCB initiatives are effective.

These lessons are in line with the conclusions emerging from a reality check of TCB initiatives in Africa conducted by the OECD Development Cluster and the United Nations Economic Commission for Africa in summer 2002 (Box 5). For sure, African

countries now have a better understanding of policy issues, and have been participating more actively in the current round of multilateral trade negotiations. Nonetheless, a “new culture of trade capacity building” is needed — one which can help to strengthen Africa’s capacity to identify its interests in and influence on international trade policy discussions and negotiations. As stressed by the Kenyan Ambassador to the WTO at the Mombasa Workshop, TCB in the context of the Doha Development Agenda is “one way to make trade work for development”.

Box 5. Trade Capacity Building: Experiences in an African Context

In an attempt to perform a reality check of TCB initiatives, the OECD and the UN Economic Commission for Africa jointly organised a workshop in Mombasa in August 2002. The workshop brought together policy makers, private sector representatives and donors. It highlighted some successes and best practices in TCB, pointing to the positive impact of the Joint Integrated Technical Assistance Programme (JITAP) in strengthening the trade policy process and developing a credible mechanism for dialogue.

Positive effects are reflected in the more active participation of African countries in the current round of multilateral trade negotiations. However, many participants shared the view that their efforts had yet to deliver results. While some participants noted that “lack of resources has never been reason for lack of impact”, others pointed to the general lack of coordination and the proliferation of initiatives, describing TCB as “a jungle”. In this respect, Lesotho represents an interesting case, where several processes (including the Integrated Framework, the WTO-led Trade Policy Review Mechanism and the UNCTAD-led Investment Policy Review) are about to be conducted simultaneously.

The workshop confirmed that there is frequently poor communication not only within donor agencies but also between capitals and their country-level representatives. Donor capacity on trade-related issues in the field is generally inadequate.

The low level of national absorptive capacity and the need for prioritisation were also emphasised. Where national administrations are weak, non-state actors are poorly organised and absorptive capacity for TCB is low, one cannot expect to build trade capacity in all relevant areas simultaneously.

At the same time, identification of TCB needs is best initiated by the country requiring that help. Externally-funded initiatives can support this process, but cannot be substitutes for a national trade strategy, based on a realistic evaluation of the trade potential of the country and supply-side bottlenecks.

Ways forward:

- Shift the centre of African trade knowledge to Africa by strengthening local and regional networking capacity. Regional organisations, such as the UNECA, could act as institutional anchors for such networks;
- Foster a new “culture of capacity building” through sharing of information and knowledge, learning by doing, networking and pooling resources at the national, sub-regional and regional levels;
- Enhance multidisciplinary, applied research capacity which meets the needs of public and private sector actors;
- Streamline and co-ordinate trade capacity building activities and programmes, based on priorities defined in the country;
- Foster greater engagement by donors in the field to ensure that programmes are coherent and sustainable, with adequate follow-up and monitoring;
- Integrate TCB and private sector development activities more closely, as trade, investment and entrepreneurship are intertwined;

Source: Adapted from OECD (2002).

ANNEX

Country Classification and Data Coverage

For most of the countries considered in this paper, OECD trade data begin in 1961. In order to ensure the greatest possible coverage, while preserving consistency and maximising statistical reliability, five-year averages were computed, starting from the first period 1966-70. Countries for which reliable data were not available before 1980 were excluded. This meant excluding 14 of the 66 countries classified by the World Bank as "low-income" in 2002 (i.e. economies having a 2001 gross national income per capita of \$745 or less). The excluded countries are Armenia, Azerbaijan, Bhutan, Eritrea, Georgia, Kyrgyz Republic, Moldova, North Korea, São Tomé and Príncipe, Solomon Islands, Tajikistan, Timor-Leste, Ukraine and Uzbekistan. Besides the 52 low-income countries, another 46 economies, classified as developing countries in the early 1970s, are considered for historical comparison, bringing the total to 98 countries. Finally, five low-income countries for which data are available only after 1975 were not included in summary statistics presented in Table 1 (but they are shown in Annex Table). These countries are Central African Republic, Comoros, Lesotho, Nepal and Papua New Guinea.

Classification of Exports

The export product groups follow the classification introduced by Wood and Mayer (1998). Using the SITC classification (revision 2), goods are grouped into broad primary products and manufactured products. Manufacturing is further divided into two sub-groups, according to the skill intensity of production.

Broad Primary Products (BP) includes SITC categories 0 (Food and live animals), 1 (Beverages and tobacco), 2 (Raw materials, inedible, except fuels), 3 (Mineral fuels, lubricants and related materials), 4 (Animal and vegetable oils and fats), plus a few items in group 5 (522.24, 522.56, 524), 6 (667, less 667.29, and 68) and 9 (941, 971). Broad primary products are sub-divided into two sub-groups, processed and unprocessed (see Wood and Mayer, 1998, for details).

Low-skill Manufactures (LSM) includes items from categories 6 and 8 (Manufactured goods, such as leather manufactures, textiles, clothing, travel goods and footwear, fabricated metal products) and a few items from category 7 (78 and 79, transport equipment other than road motor vehicles and aircraft).

High-skill Manufactures (HSM) includes primarily category 5 (Chemicals and pharmaceutical products), 7 (Machinery and transport equipment) and a few items from category 8 (Scientific instruments, watches and photographic equipment).

Annex Table provides summary statistics on structural changes in the export profile of the 98 countries considered. Data refer to two five-year periods (1966-70 and 1996-2000) unless otherwise specified. For each country, data are provided on the share of broad primary products in total exports (column one and three) and their share in OECD markets (column two and four) over the relevant period. Column five summarises the direction of change in both diversification and market share. Countries that managed to increase both the share of manufactures and their weight in OECD imports are designated as "1". Countries that diversified away from broad primary products but saw their weight in OECD imports decreased are designated as "4". A smaller (lower) share of manufactures coupled with bigger (smaller) weight in OECD imports is represented by "2" ("3"). Similarly, column six summarises the change in the share of manufactures exports in total exports and processed primary products in total exports. Countries that both increased these shares are placed in the first quadrant (upper-right) and are designated as "1". Countries that experienced a reduction in both, are located in the third quadrant (bottom-left) and are designated as "3". Higher (lower) manufactures exports combined with lower (higher) processed primary exports is represented by a "4" ("2").

Annex Table. **Structure of Exports in Low-Income Countries (1966-2000)**

	1966-70		1996-2000		Diversification with growth	Primary processing
	BP share	TX share	BP share	TX share		
<i>Afghanistan</i>	77	0.02	64	0.00	4	4
<i>Bangladesh</i>	46	0.03	7	0.12	1	4
<i>Cambodia</i>	99	0.01	4	0.02	1	4
<i>China</i>	70	0.41	9	4.73	1	4
<i>Fiji</i>	99	0.00	52	0.01	1	1
<i>Hong Kong, China</i>	5	0.78	4	0.72	4	4
<i>India</i>	59	0.70	20	0.63	4	4
<i>Indonesia</i>	98	0.48	45	0.96	1	4
<i>Korea Rep.</i>	34	0.21	9	1.81	1	1
<i>Laos</i>	64	0.00	18	0.00	1	1
<i>Malaysia</i>	97	0.59	14	1.29	1	4
<i>Mongolia*</i>	95	0.00	55	0.00	1	4
<i>Myanmar</i>	99	0.03	26	0.01	4	4
<i>Nepal****</i>	(43)	0.00	1	0.01	1	4
<i>Pakistan</i>	57	0.21	8	0.13	4	4
<i>Papua N. Guinea****</i>	(98)	0.08	99	0.04	3	2
<i>Philippines</i>	90	0.57	13	0.60	1	4
<i>Singapore</i>	78	0.12	5	1.15	1	4
<i>Sri Lanka</i>	98	0.13	13	0.09	4	4
<i>Thailand</i>	96	0.22	23	0.98	1	4
<i>Viet Nam</i>	86	0.02	39	0.17	1	1
<i>Argentina</i>	94	0.76	77	0.22	4	1
<i>Bahamas*</i>	73	0.11	53	0.02	4	4
<i>Barbados*</i>	71	0.01	38	0.00	4	4
<i>Belize*</i>	88	0.01	89	0.01	3	3
<i>Bolivia</i>	99	0.08	74	0.01	4	1
<i>Brazil</i>	94	1.04	54	0.82	4	1
<i>Chile</i>	99	0.55	90	0.27	4	4
<i>Colombia</i>	96	0.31	83	0.23	4	4
<i>Costa Rica</i>	98	0.08	48	0.12	1	4
<i>Cuba</i>	96	0.09	96	0.02	4	1
<i>Dominican Rep.</i>	97	0.10	16	0.12	1	4
<i>Ecuador</i>	99	0.14	95	0.10	4	1
<i>El Salvador</i>	99	0.08	26	0.05	4	4
<i>Guatemala</i>	98	0.10	54	0.08	4	4
<i>Guyana</i>	94	0.06	89	0.01	4	4
<i>Haiti</i>	75	0.03	15	0.01	4	4
<i>Honduras</i>	99	0.10	32	0.08	4	4
<i>Jamaica</i>	92	0.17	62	0.04	4	1
<i>Mexico</i>	78	0.79	16	2.96	1	4
<i>Nicaragua</i>	98	0.08	60	0.02	4	4

Annex Table (continued)

	1966-70		1996-2000		Diversification with growth	Primary processing
	BP share	TX share	BP share	TX share		
Paraguay	89	0.02	81	0.01	4	4
Peru	99	0.48	81	0.10	4	4
Suriname *	98	0.05	96	0.01	4	1
Trinidad & Tobago	94	0.19	57	0.05	4	4
Uruguay	77	0.09	60	0.02	4	4
Venezuela	99	1.05	91	0.43	4	4
Algeria	98	0.50	88	0.31	4	1
Cyprus	96	0.05	34	0.02	4	4
Djibouti	83	0.00	51	0.00	4	4
Egypt	89	0.13	58	0.10	4	1
Iran	93	0.94	92	0.26	4	4
Lebanon	83	0.05	28	0.01	4	4
Malta	32	0.01	4	0.03	1	4
Morocco	95	0.26	38	0.17	4	4
Tunisia	89	0.08	18	0.14	1	4
Yemen	96	0.04	95	0.01	4	4
Angola	99	0.17	100	0.10	3	3
Benin	99	0.01	83	0.00	4	4
Botswana *	99	0.00	86	0.01	1	1
Burkina Faso	99	0.00	77	0.00	4	4
Burundi	100	0.02	99	0.00	4	4
Cameroon	99	0.11	97	0.05	4	1
Central Afr. Rep. ***	(99)	0.01	99	0.00	3	3
Chad *	100	0.01	94	0.00	4	4
Comoros *****	(68)	0.00	65	0.00	4	1
Congo Rep.*	88	0.03	96	0.03	2	3
Congo Dem. Rep.	99	0.37	95	0.03	4	4
Cote d'Ivoire	99	0.24	94	0.08	4	1
Equatorial Guinea	99	0.01	97	0.01	4	4
Ethiopia	97	0.06	86	0.01	4	4
Gabon	94	0.12	97	0.06	3	3
Gambia	99	0.01	97	0.00	4	4
Ghana	98	0.17	88	0.04	4	1
Guinea *	98	0.02	99	0.02	2	3
Guinea Bissau *	97	0.01	94	0.00	4	1
Kenya	90	0.09	88	0.03	4	4
Lesotho ****	(28)	0.00	20	0.00	1	4
Liberia	93	0.15	47	0.02	4	1
Madagascar	93	0.05	55	0.02	4	4
Malawi	99	0.02	98	0.01	4	1
Mali	96	0.00	83	0.00	4	4
Mauritania	99	0.05	98	0.01	4	1

Annex Table (continued)

	1966-70		1996-2000		Diversification with growth	Primary processing
	BP share	TX share	BP share	TX share		
Mauritius *	97	0.03	29	0.04	1	4
<i>Mozambique</i>	96	0.09	93	0.00	4	4
<i>Niger</i>	100	0.02	91	0.00	4	1
<i>Nigeria</i>	98	0.42	98	0.31	3	3
<i>Rwanda</i> *	99	0.01	98	0.00	4	1
<i>Senegal</i>	98	0.08	92	0.01	4	4
<i>Sierra Leone</i>	99	0.06	69	0.00	4	1
<i>Somalia</i>	97	0.01	73	0.00	4	4
South Africa *	86	0.73	67	0.47	4	4
<i>Sudan</i>	99	0.09	93	0.01	4	1
<i>Tanzania</i> *	94	0.05	91	0.01	4	4
<i>Togo</i>	99	0.03	90	0.00	4	1
<i>Uganda</i>	100	0.09	98	0.01	4	4
<i>Zambia</i>	99	0.43	83	0.01	4	4
<i>Zimbabwe</i>	93	0.02	73	0.03	1	1

Note : "BP share" is the share of broad primary products in total exports (TX). "TX share" indicates the country's share in OECD high-income countries' imports. Low-income countries are defined by the World Bank as of 2002 (italic).

Data cover the period 1966-2000, except few countries for which data only available from (*) 1970, (**) 1973, (***) 1975, (****) 1976 and (*****) 1978. Countries for which data are available only after 1975 are excluded from Table 1.

Source : Authors' own computations based on OECD Foreign Trade Statistics Database (2002).

NOTES

1. This paper adopts a broad definition of “primary commodities”, which encompasses both “energy” and “non-energy commodities”. The latter include beverages (e.g. cocoa, coffee, and tea), fats and oils, grains, food (e.g. sugar, fruits, vegetables, fish, and meat), raw materials (e.g. cotton, wool, and sisal), fertilisers, metals and minerals. Hence, “primary commodities” and “natural resources” are used interchangeably in what follows.
2. See Collier and Hoeffler (2001), Ross (2001) and Leamer *et al.* (1999), respectively. The development experience of many African countries amply demonstrates how gold, diamonds and oil can disrupt social and ethnic relationships and cause unrest and civil war. As the UK Secretary of State for International Development recently put it, mineral wealth has been a curse not a blessing for many African countries. She said: “If you look at the countries in Africa which have been misgoverned, corrupted and ravaged, they are almost always the ones rich in natural resources” (*The Guardian*, 10 February 2003).
3. See Vitalis (2003) for a useful review of market access issues and the impact of developed countries’ trade policies on developing countries.
4. A distinction is sometimes made in the literature between “resource curse” and “commodity pessimism”. The first specifically refers to the harmful consequence of mineral discoveries on domestic production, while the latter refers to the gloomy export outlook associated with world demand for commodities. This paper makes use of “resource curse” in the broadest sense, to include both demand and supply-side issues.
5. Ng and Yeats (2002) estimated income elasticities for some thirty-five traditional and non-traditional primary products and found that the vast majority of them had either static or negative demand growth prospects. In particular, assuming a 2.5 per cent world GDP annual growth rate, they estimated that global trade in traditional products should grow by under one per cent a year. Mayer *et al.* (2002) confirm this pessimistic view. By using a comprehensive measure of export dynamism, which controls for long-term and short-term growth, as well as volatility, they found that no primary commodity ranked among the most dynamic products.
6. See Leamer *et al.* (1999) for further discussion.
7. Maloney (2002) constructed long time-series data for the 1820-1989 period and found that the negative effect of resource-abundance on growth only emerged in the second half of the 20th century, mainly because of the underperformance of Latin American countries.
8. See, in particular, Elbadawi (2001) and Sekkat and Varoudakis (1998) on the negative impact of exchange-rate misalignment on the competitiveness of manufactured exports. Lederman and Xu (2001) and Collier (2002) provide additional evidence on a variety of factors affecting a country’s trade structure.
9. The LDC Report 2002 estimated that real commodity prices of LDC non-fuel exports declined by over 30 per cent between 1986 and 1999. This downward trend was temporarily reversed between 1993 and 1997, but since then they had started to fall again. For instance, between 1997 and 2001, copper

prices fell by 27 per cent, cotton prices by 39 per cent and coffee prices by 66 per cent (UNCTAD, 2002, Chapter IV).

10. Moreover, the high variability and persistence of shocks are likely to endanger the sustainability of stabilisation schemes, either through domestic government intervention such as stockholding, price support and external borrowing, or through international market-sharing agreements. Indeed, stabilisation schemes have performed quite poorly and have been mostly dismantled. Emphasis is now placed on programmes that deal directly with market uncertainty by using market-based commodity risk management instruments. Despite increased availability, important barriers in accessing these instruments still exist, especially for small farmers (Larson *et al.*, 1998).
11. As of 2000, only four of the 27 LDC non-oil commodity exporters (Bhutan, Eritrea, Solomon Islands and Uganda) had sustainable levels of external debt, according to the criteria of the enhanced HIPC Initiative (UNCTAD, 2002).
12. See, for example, Berthelemy and Söderling (2000) and Funke and Ruhwedel (2000) regarding the linkages between diversification and growth.
13. The 23 high-income OECD countries are Australia, Canada, EU (15), Iceland, Japan, New Zealand, Norway, Switzerland and the United States.
14. Table 1 excludes five low-income countries (Central African Republic, Comoros, Lesotho, Nepal and Papua New Guinea), because the trade data for these countries are not available for the period between 1966 and 1970.
15. Bangladesh, Indonesia, Philippines, Thailand and Viet Nam stand out as the most important examples. It was only in the 1980s that these countries moved from traditional models of production towards a modern agricultural model in both shrimp aquaculture and industrial tree plantation.
16. With apparel export amounting to \$260 million, Lesotho accounted for 25 percent of total apparel exports to the US originating in sub-Saharan Africa over April 2001-April 2002, surpassing both South Africa (\$167 million) and Mauritius (\$244 million). In one year, apparel exports to the US increased by 68 percent. Lesotho's industrial base is still very narrow, covering clothing, footwear and assembled colour TV sets. See the Integrated Framework (2003).
17. Lesotho is a telling example. Under the current rules of origin of AGOA, this country is entitled to a special status, allowing clothing manufacturers to use cheap inputs from Asia. By September 2004, the rules of origin will require that all African apparel suppliers to the US market use fabric and yarn either made in Africa or imported from the US. Under this threat, investors in the clothing sector may even decide to relocate. A window of opportunity could be created within the new trade agreement that is being negotiated between the US and the South African Customs Union, where less stringent rules of origin could be incorporated.
18. An example is the Chilean copper cluster, which has spurred the rise in engineering and consultancy services (Buitelaar, 2001; Fisher, 2001) and the forestry sector in Sweden, which has generated downstream demand for paper and pulp technologies and transport equipment (World Bank, 2002; Blomström and Kokko, 2003).
19. See Friedland (1994) on how technological advances enabling long-distance "cool chains" and changes in consumption behaviour toward healthier diets have prompted the globalisation of fresh produce. See also Dolan and Humphrey (2000) on the governance structure of fresh produce commodity chains.
20. Bonaglia and Fukasaku (2002) review the implementation of structural adjustment programmes in six African countries (Ethiopia, Kenya, Madagascar, Mozambique, Tanzania and Uganda) with focus on trade policy reform, and briefly discuss the impact on their economies.
21. See Lall (2002) for a useful review of this literature.

22. Besides traditional arguments encouraging the processing of primary commodities which are summarised in Section II, changes in demand patterns in OECD countries — reflecting changing dietary habits but also increased awareness in (and willingness to pay for) food quality, health and environmental protection — have contributed to a renewed interest in exporting high-value specialty food products.
23. On this point, see Cramer (1999) and his recent article “Should Developing Country Industrialisation Policies Encourage Processing of Primary Commodities?”, *The Courier*, No. 196, January-February 2003.
24. A clear vision for the sector as a whole and the co-ordination of sector agents are probably the main reasons why, despite the high quality of Ethiopian coffee, “Café Colombia” is a world-famous brand and “Café Ethiopia” is not. Another example is the case of Ugandan fish exporters in their efforts to regain access to European markets after the EU ban. This owes much to a joint effort and investment by the exporters association, government and donors.
25. This was pointed out in a series of *Executive Forums* organised by the ITC on the theme of trade promotion and export strategy making. In line with the results of Bonaglia and Fukasaku (2002), ITC highlights the absence of a working partnership between the public and private sectors and the limited familiarity of strategy-makers with relevant “process” and “decision-support” tools.
26. Keesing (1983) and Kirchbach (1988) provide a conceptual framework for analysing the impact of trade support services on exporters’ competitiveness.
27. ITC conducted a series of country surveys in 1997 aimed at assessing barriers to international business development as perceived by exporting firms and business associations in LDCs. The results from these surveys conducted in the 48 LDCs showed that both enterprises and business associations regarded inadequate trade support services and the existence of inappropriate government policies as the most severe obstacle to international business development.
28. In particular, the slow and unplanned development of transport services within and between countries imposes a heavy toll on exporters of these countries, where, due to the unprocessed nature of most exports, freight costs often represent a high share of export value (see Bonaglia and Fukasaku, 2002).
29. The unsatisfactory performance of trade promotion organisations (TPOs) in Ethiopia and Kenya seems to be fairly representative of many trade promotion organisations in developing countries. As Keesing and Singer (1990) point out, an “original sin” undermines the functioning of these organisations and explains their poor performance. Born under the umbrella of import-substitution policies, TPOs were not intended to overcome the supply constraints of domestic firms, but only to handle the foreign marketing of existing commodities. They therefore developed and perpetuated the “wrong” skills and subsequently opposed any attempt at reform.
30. Recent case studies on enterprise networks in Africa (OECD, 2000) confirm this claim, pointing to the virtual inexistence of established processes for public-private dialogue on trade issues.
31. Mauritius’ multi-ethnic composition is probably an important factor leading to the adoption of such a participatory approach to policy making. Mauritius has a long tradition of parliamentary democracy, dating back to the colonial years under British rule (the first general elections on the basis of universal adult suffrage took place in 1959). The Constitution of Mauritius guarantees fundamental human rights and provides for the protection of minorities through the allocation of certain number of seats to the highest polling unsuccessful candidates belonging to under-representative ethnic groups, in order to balance the representation of ethnic communities. Effective participation of civil society organisations in the social and political debate has always been encouraged.

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