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ANALYSIS OF NATIONAL EXPERIENCES IN HORIZONTAL AND VERTICAL DIVERSIFICATION, INCLUDING THE POSSIBILITIES FOR CROP SUBSTITUTION

Report by the UNCTAD secretariat

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CONTENTS

I. INTRODUCTION: COMMODITY DEPENDENCY AND DIVERSIFICATION EXPERIENCE IN DEVELOPING COUNTRIES

1. The United Nations Conference on Trade and Development agreed, at its eighth session, that one of the goals to be pursued by the international community was achieving a gradual reduction in the excessive dependence of countries on the export of primary commodities through horizontal as well as vertical diversification of production and exports, and that international support should be directed towards assisting such efforts. The Conference also reaffirmed that UNCTAD should continue to assist in diversification as well as processing, marketing and distribution programmes.[1] The work programme of the Standing Committee on Commodities, agreed upon at the Committee's first session, includes, in the context of reducing excessive dependence on primary commodities, the analysis of national experiences in horizontal and vertical diversification, including the possibilities for crop substitution.

2. In accordance with this mandate, the UNCTAD secretariat is undertaking a series of country case studies on diversification experience. Studies on Cameroon, Colombia, Senegal, Solomon Islands and the United Republic of Tanzania are approaching completion and have been used as the basis for the illustrative examples in this report. Diversification experience in these countries varies substantially: while Colombia is an example where diversification into a wide range of non-traditional products has been quite successful, Cameroon, Senegal and the United Republic of Tanzania have achieved only some limited results, mainly in horizontal diversification, and the Solomon Islands has few results to show as yet. The document also draws on other studies undertaken inside and outside of UNCTAD on national diversification experiences, including with respect to crop substitution.[2] While the focus of the document is on export-oriented activities, this should not be construed to mean that diversification efforts to meet the requirements of the domestic market are not important. However, in most cases diversification in the commodity sector will involve at least some export orientation because of the limited size of domestic markets in the majority of developing countries.

3. A common characteristic of the vast majority of developing countries is the high proportion of commodity exports in foreign exchange earnings. The production and export of commodities are the principal activities for generating domestic savings, external resources and employment and provide the material base for economic growth and development. It is also a common feature of many commodity-dependent developing countries that they rely for the major part of their export earnings on a very limited number of primary commodities. As their level of production of these commodities is often variable, and prices are volatile and determined on international markets, these countries' export earnings are very vulnerable to events over which they have no control.

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[1] Cartagena Commitment (TD/364), paras. 190, 203 and 211.

[2] See annex I for a bibliography of studies in this area.

4. Although several developing countries are successfully diversifying out of commodities, most will continue for many years to remain heavily commodity-dependent. They may be tempted to maximize returns from short-term comparative advantages in their traditional export products, as this may seem a relatively easier task because production and support structures for these products already exist. However, it is clear that they need to take steps to diversify into activities that make their economies less vulnerable to instability on world commodity markets. While price stabilisation schemes and compensatory finance can alleviate the short-term negative effects of excessive dependency on a few export commodities, the long-term solution can only be found in diversification, which in most cases will have to be based on inputs from the commodity sector.

5. Trends in the dependency on commodity export earnings of developing countries during the 1980s varied considerably. As can be seen from annex II, while Latin American and Asian developing countries experienced a decrease in the share of commodities, including their processed forms, in total export earnings, the commodity dependency of countries in Africa, the Caribbean, and Oceania did not decrease and in some cases increased. Africa and Oceania remain the most commodity-dependent geographical areas - all countries of these groups obtain over 70 per cent of their export earnings from commodities. The most significant reduction in commodity dependency at the individual country level occurred in Asian and Latin American countries. For example, between 1979-1981 and 1988-1990, this dependency declined from 95 to 55 per cent in the Syrian Arab Republic, from 87 to 59 per cent in Mexico, from 78 to 53 per cent in Malaysia and from 73 to 44 per cent in the Philippines.

6. Vertical diversification in terms of an increase in the share of a commodity undergoing various degrees of processing before export was most evident in countries of North Africa and South and South-East Asia, while the relatively slowest progress was achieved in sub-Saharan Africa: the share of primary commodities in export earnings is still over 70 per cent in 30 out of the 42 countries of this region for which data are available. A few sub-Saharan countries, however, were quite successful in increasing the share of semi-processed or processed commodities in total exports. For example, there was a dramatic rise in the share of processed commodities in Seychelles (from 1 to 72 per cent between 1979-1981 and 1988-1990 due to exports of processed fishery products) and, to a lesser extent, of semi-processed commodities (mainly timber) in Equatorial Guinea.

7. Horizontal diversification within the commodity sector took place in many developing countries and involved a wide range of commodities, including horticultural products, cut flowers and plants, timber and fisheries, as well as mineral and agricultural commodities traditionally important in international trade. However, many of the newly exported products, although representing a potential for diversification, are not yet a significant part of export earnings. Moreover, during the past decade a number of countries have experienced the same or increasing dependency on a limited number of traditional products or have diversified into commodities which compete with other producers' traditional exports, already in oversupply on the world market.

8. There seems to be a correlation between high dependence on a limited number of non-fuel traditional export commodities and low income, with the majority of countries heavily dependent on such commodities being in sub-Saharan Africa. Over the past decade, the real export prices of traditional products, particularly cocoa and coffee, have declined considerably. This has negatively affected the foreign exchange earnings of these countries, despite efforts to increase export volumes, and has substantially limited their opportunities to diversify. In fact, despite the fall in coffee and cocoa prices, the share of these products in the export earnings of the majority of African exporters did not show a significant decline and even increased in the case of Rwanda. A few countries (e.g., Equatorial Guinea, Madagascar) managed to make up for the shrinking coffee or cocoa export earnings by increasing exports of other, both traditional and non-traditional, commodities. A similar mixed picture can be observed among Latin American coffee producers, with Brazil and Colombia successfully diversifying away from coffee. At the same time, with the sharp fall in prices for traditional crops, it has been easier for farmers of some Latin American countries to turn to growing coca and similar plants serving as raw materials for illegal drug exports. The production of coca not only pays better than traditional crops, but because it is harvested four times a year and comes from a hardier plant, it provides a more stable income.

9. The statistical information suggests that countries which have been most successful in diversification are often the already most advanced economies like Brazil and Malaysia, or countries with a fairly diversified economy which have had access to substantial external resources, such as a number of oil exporters (Venezuela, Indonesia, Trinidad and Tobago)[3]. On the other hand, less advanced countries highly dependent on a limited number of commodities with already modest and further falling export revenues have usually had less success. Exceptions have occurred, particularly in countries which were successful in encouraging export processing zones (Mauritius). However, the creation of EPZs, which are esssentially influenced by the prevailing relatively low level of labour costs, cannot be considered as a long-term solution; moreover, EPZs usually have an enclave character and, being heavily dependent on imported inputs, do not always contribute much to the processing of local primary commodities. The less advanced countries usually have neither the financial resources nor the diversified production structure which would allow them to adapt their export structure quickly. Relatively large and advanced economies with better infrastructure, developed support services, more flexible labour forces and more effective research and development programmes can more easily diversify into "new" commodities or stimulate the production of certain traditional commodities (or specific qualities of these products). It is notable also that in these counties diversification usually occurred into new additional activities, rather than as substitution for traditional activities.

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[3] See UNCTAD, "Mineral resources and sustainable development", (TD/B/CN.1/16), 1993.

II. NATIONAL EXPERIENCES WITH DIVERSIFICATION IN THE COMMODITY SECTOR, INCLUDING IN THE AREA OF CROP SUBSTITUTION

10. The opportunities for developing countries to diversify their commodity exports depend on a combination of various domestic and external factors. As constraints on diversification, as well as measures used to encourage it, vary from one country to another and also from commodity to commodity, diversification across commodities and countries has developed in a remarkably non-uniform manner. From the ongoing research and previous analyses of countries where diversification has taken place on either a vertical or a horizontal basis, it is not possible to pinpoint a list of individual factors and conditions which could be universally utilized. However, the experiences reveal some interesting common characteristics.

11. The cases of successful commodity-related export diversification in developing countries demonstrate that it has usually resulted from a combination of various favourable basic factors and external and domestic conditions, including those which are a consequence of government action. The conditions include, as would be expected, the availability of domestic and international markets for non-traditional products, of adequate financial resources for investment in diversification-related activities, of appropriate infrastructural facilities, of qualified labour and personnel, of research and development activities, of information and of extension services. In most low-income highly commodity-dependent developing countries, the lack of several of these factors has set serious constraints on diversification efforts. However, this has not necessarily prevented diversification: in a number of cases these countries have successfully developed specific non-traditional export activities. What seems to be common to all successful diversification experiences is that they have benefited from supportive government policies and actions at the macro and sectoral level. This chapter discusses various categories of factors and conditions pertinent to the question of viable commodity-related diversification using country-specific illustrative examples .

A. Basic factors

12. The geophysical and climatic characteristics of a country are important determinants of its capacity to diversify. The territorial size, location and topography of a country significantly influence, inter alia, the nature and cost of transportation, the accessibility of land for agriculture, the conditions of access to raw materials, and the feasibility of marketing certain perishable products. The climate may be favourable for diversification, activities or it may severely limit opportunities because of recurrent droughts, floods, hurricanes or other adverse weather conditions. The success of efforts to diversify horizontally and, to a certain extent, vertically also depend on the endowment of a country in natural resources in the agricultural, fishery, forestry and mineral sectors. Diversification may also depend on the availability and timely supply of inputs like fertilizers and pesticides or packaging materials and, especially in case of diversification into processing activities, availability of appropriate secondary inputs and their regular supply, as well as a reliable supply of primary materials of adequate quality.

13. Another basic factor influencing the viability of diversification efforts is the availability of a sizeable domestic market. Experience shows that in the initial period diversification

activities in many countries were geared to satisfying domestic needs, especially food requirements, with exports often coming at a later stage as a supplement to the local market. However, in a number of cases, especially large and medium-scale mineral production and processing projects, diversification efforts have been export-oriented, with domestic consumption expected to absorb only a small part of the output.

14. In Colombia, diversification efforts have benefited from a vast mineral and agricultural resource base, as well as from favourable geophysical and climatic conditions, with the latter varying enough among regions to allow the growing of a wide range of products. In particular, the geographical location and climate of the Bogota area are very favourable for the development of export-oriented production of flowers. Export diversification has reflected both the diversification of the national economy (production of ferronickel, flowers and processing of several agricultural products) and the growing export orientation of sectors which were traditionally oriented towards the domestic market and which were promoted by the import-substitution policy followed during the 1970s (production of oil and coal, processing of cocoa, sugar, cotton and hides and skins). Most minerals exploited in the country are still destined for the local market. This was also the case of the main one, coal, until 1985 when exports started to expand rapidly. In many cases the setting-up of processing enterprises, in particular in the leather, cotton, cement, sugar and cocoa sectors, was initially oriented towards supplying the domestic market, and later expanded to exports. However, the production of ferronickel, coffee extracts, silk, citric acid and canned pineapples was set up primarily to supply international markets.

15. In contrast, the Solomon Islands are characterised by a widely dispersed territory and related high transport costs. Despite generally poor soil conditions, the country is rich in mineral resources and, especially, in natural tropical forest, which is currently being logged on a large and unsustainable scale, leading to its depletion. The surrounding seas provide a variety of marine resources, many of which are still not adequately exploited. The very small and fragmented domestic market explains the export orientation of forestry, fishery, mineral (gold) and main cash crop production. The lack of fertilisers and other input supplies, as well as the regular occurrence of cyclones, have also negatively affected diversification opportunities in agriculture.

16. In comparison to other countries of the West African coast, Senegal has a rather limited agricultural and mineral resources potential. As with other Sahel countries, diversification within the agricultural and livestock sectors is vulnerable to severe droughts, uneven rainfall and locust infestations. The country has a natural advantage in growing horticultural products for the European market, being one of the countries closest to Europe where these products can be grown in open fields during the European off-season period. However, transportation costs are relatively high for Senegal.[4] The limited Senegalese domestic market has been negatively affecting the growing of horticultural products, as surplus production over exports could not be

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[4] In comparison, significantly lower transport costs were an important reason for Mexico's domination of the United States market for off-season products.

absorbed locally.[5] Limited domestic consumption and the seasonal character of agricultural production has also discouraged the development of processing industries. On the other hand, the domestic market absorbs about two thirds of national production of phosphate fertilizers, with the rest going to countries in the sub-region.

17. Neither Cameroon nor the United Republic of Tanzania have benefited from the availability of a sizeable domestic market, but both have very large and diversified natural resource bases. The geographical location of both countries, as they are relatively close to the European market and are not land-locked, is also rather favourable, while agroclimatic conditions, with the exception of some areas (i.e. tea growing areas in the United Republic of Tanzania which are often affected by droughts) are generally good. Agricultural production is oriented at both domestic and international markets, with the latter consuming almost entirely major cash crops and non-traditional products. However, this production has suffered from the lack, or untimely supply, of fertilizers and other inputs, including packaging materials, while processing industries (i.e. cashew nut processing plants and the textile industry in the United Republic of Tanzania) have been facing raw material supply shortages.

18. Different factors have limited or opened up the scope for diversification in other developing countries. For instance, in Bangladesh floods have frequently caused supply problems for export-oriented agro-industries, and the frequency of cyclones has inhibited diversification into crops such as papayas and mangoes in Mauritius. Many developing countries have already been hit by erosion of their soils or have exploited a substantial part of their mineral resources (depletion of resources of bauxite in Haiti or phosphates in Kiribati). Another problem consists of the lack of reliable supply of high-quality primary products to processing sectors, which was, in particular, one of the key factors inhibiting the expansion of exports of processed fruits and vegetables from Zimbabwe.[6]

19. A number of countries with internal markets of limited effective size have successfully developed export-oriented activities (development of capital-intensive production of steel, methanol and urea in Trinidad and Tobago which was financed from oil revenues[7] or of European market-oriented production of cut flowers and canned pineapple in Kenya[8]). However, a sufficiently large internal demand may be especially relevant for diversification through large-scale agricultural projects, as it reduces the vulnerability associated with investments that rely exclusively on export markets. For instance, the existence of sufficient internal demand for

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[5] In the case of Kenya, such products have benefited from a much larger internal demand.

[6] R. Riddel, p. 35.

[7] Williams, P., "The growth of non-traditional exports in the Caribbean", The Courier, No 127, 1991, p. 85.

[8] C. Stevens, pp. 28-40.

soyoil and palm oil were the major factors in the development of the soya complex in Brazil and of the most developed African palm oil processing industry in Côte d'Ivoire.[9]

20. It is clear from the experience of individual, especially highly commodity-dependent developing countries that basic factors have often represented a significant constraint for the successful development of diversification activities. This is not to say that small, resource-poor, land-locked or island countries cannot diversify; in such cases it is usually a question of considering ways of mitigating or circumventing the existing constraints.

B. Domestic and external conditions

21. In most developing countries, scarce financial resources limit the extent to which national diversification opportunities can be identified and realised. In the majority of diversification projects implemented in developing countries, local financing plays an important role. At the same time, the local economy and the local financial market are often too small to raise the necessary capital. This makes diversification dependent on the attraction of foreign investment. However, foreign private capital flows to developing countries continued to be concentrated on a limited number of countries and sectors, giving, with a few exceptions, comparatively little attention to less advanced, highly commodity-dependent countries. For instance, since the second half of the 1970s, there has been no significant foreign investment in the mining sector of Africa outside of Botswana. The ratio of exploration expenditure to total production in recent years has averaged less than 1.2 per cent in practically all major African mineral producers, while this figure averaged from 6 to 14 per cent for operations undertaken in Canada and Nevada and in gold mining in Australia.[10] In these circumstances, many commodity-dependent developing countries have had to rely on official development finance (bilateral and multilateral) for a substantial part of their investments, and a relatively small proportion of this finance has been directed to commodity-related export-oriented activities.[11]

22. Another problem is that poorly developed infrastructure (transportation and storage facilities, power and water supply, irrigation systems and telecommunications) has resulted in high additional costs for enterprises, many of which have to use their own resources to secure adequate infrastructural facilities. In addition, this reduces incentives for market-oriented agricultural production, as markets are difficult to reach for farmers and traders. Shortages of skilled labour, managerial capacities and technical expertise are also serious constraints on diversification efforts, especially in Africa and Oceania.

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[9] UNCTAD/ST/CD/2, paras. 93 and 100.

[10] P. Fozzard, p.101.

[11] In 1984-1988, annual resource flows from the main international and regional financial institutions to commodity-related diversification activities with some export orientation in developing countries represented approximately 5 per cent of the total commitments of these institutions (TD/B/C.1/AC/12, para. 42).

23. To be viable, export diversification efforts require not only a solution of the complex problem of identification of export markets, but also of penetration and maintenance of these markets. For many countries and products, market access conditions still remain a constraint. Although applicable tariffs in the three major markets - the European Community, the United States and Japan - are usually low for primary commodities, they are more significant for agricultural commodities competing with locally produced products and tend to escalate with the stage of processing. Barriers to access to markets of developing countries are often very difficult to surmount. Although most developing countries have preferential access to markets of developed countries under the generalized system of preferences, the Lomé Convention, the Caribbean Basin Initiative (CBI) and other schemes, the existing schemes often do not provide concessions for those products in which developing countries are competitive and have already developed a substantial production capacity. For example, sugar, apparel and other key products are either excluded from the CBI or are subject to strict country quotas. Moreover, the conclusion of preferential agreements with a limited group of, or even individual, developing countries (such as the free trade agreement between the United States, Canada and Mexico) and the absence of similar agreements with other developing countries can significantly hinder the prospects for export diversification of the latter.

24. In Colombia, the underdeveloped capital market and scarce domestic financial resources means that finance is expensive and difficult to obtain, despite the fact that a few entrepreneurs have access to drug money. Local private investment capital has only contributed substantially to the development of the flower sector, while its support for the development of fishery products as well as of fruit and vegetable export industries has been much more limited. While Colombian infrastructure is still domestically oriented, some recently created facilities were designed for specific export industries and have contributed to the development of other exports: infrastructure initially created for flower exports played an important role in making fruit exports possible. New industries usually have at their disposal a relatively cheap and well trained labour force, though skills in some areas, especially export marketing, are still not adequate. The availability of cheap labour and technical skills necessary to adopt new techniques and adapt them to local conditions has been a major factor in the successful development of flower exports.

25. Although most Colombian exports, including non-traditional commodities, benefit from a number of preferential agreements, they often face market access problems. In order to overcome these problems, the government has provided support adapted to the needs of specific sectors. For instance, when anti-dumping and compensatory rights actions became a major obstacle for flower exports to the vitally important United States market, the cost of lawsuits was financed out of the government-administered Diversification Fund.

26. In the Solomon Islands, the limited domestic savings potential explains the scarcity of local capital and the increasing use of external loans by the private sector. Economic activity is severely constrained by the poor state or lack of infrastructure, which is a particularly acute problem in this country with its population scattered across scores of islands. The infrastructure for processing fish is already in place, but is underutilised and needs rehabilitation. There is a general lack of technical, managerial and marketing skills, while educational and training

opportunities remain limited. With the exception of copra, the exports of major products - palm oil and kernel, coconut oil, tuna, lumber and wood products - are handled by multinational corporations. The country faces few access barriers on its exports of commodities to all of the major markets.

27. In the three African countries studied - Cameroon, Senegal and the United Republic of Tanzania - the limited savings potential, chronic shortage of domestic financial resources and weakness of the national banking systems constitute major constraints on investment, while deficiencies in infrastructure have a negative impact on diversification efforts. In Senegal, infrastructure for storage of fish is insufficiently developed and has gradually deteriorated, while efforts to diversify into horticultural exports have been hampered by poor air freighting and storage facilities. The port of Dakar is not able to load the large ships common in phosphate trade. Agricultural products from remote areas are unlikely to be competitive on international markets until transportation and storage facilities can be improved. The cost of labour in Senegal remains high in relation to most other African countries, and skills are lacking in many areas. Furthermore, labour code regulations preventing seasonal short-term employment is a disincentive to investments in activities with seasonal variations in production. Although Senegal (along with other African countries) enjoys preferential access to developed countries' markets, some obstacles still remain which discourage exports of non-traditional commodities in primary and especially processed forms.[12] High tariffs in neighbouring African markets remain an additional constraint on Senegalese export-oriented processing of commodities.

28. In the United Republic of Tanzania, insufficient local finance, coupled with severe shortage of foreign exchange, creates obstacles to maintaining what is in any case an inadequate infrastructure. There has been a rapid deterioration of the transport network, which has resulted in difficulties in delivering raw materials to processing plants. For instance, railway bottlenecks have contributed to the congestion of transport and storage facilities in periods of increased cotton production, making the processing of part of the crop impossible. Inadequate export infrastructure also hampers exports of horticultural products and cut flowers. Skills are lacking in the country, especially in the area of marketing at the private enterprise level. Textile exports were initially oriented to neighbouring countries, but due to those countries' foreign exchange problems and very restrictive import policies, attention was later shifted to the relatively more open EEC market.

29. In Cameroon, the dramatic fall from the mid-1980s in domestic savings and investment capacity, accompanied by capital flight, has significantly aggravated the problem of inadequacy of financial resources. The deep economic crisis of the country has led to a degradation of infrastructure, in particular in respect of transport and storage facilities for the production of

[12] Joint ventures with foreign partners have been used as a way of overcoming these obstacles: in order to secure access to the Japanese phosphate market, Nissho-Iwai was allowed to invest in Senegalese phosphate production, while the participation of foreign partners in horticultural production was found necessary for access to distribution networks in European and American markets.

processed and non-traditional commodities. Any expansion of fishing capacities would require prior rehabilitation and modernization of cold chain and freezing facilities, while the development of identified sizeable natural gas and bauxite reserves is constrained by the lack of appropriate infrastructure. The direction of exports of primary and processed commodities is largely influenced by preferences granted under the Lomé Convention and, to a much lesser extent, by preferential arrangements with neighbouring UDEAC countries. The processing of cocoa, wood, tobacco and aluminium is controlled by foreign shareholders who handle international marketing through their own channels.

30. Experiences of other developing countries confirm the importance of the above-mentioned conditions for the success of diversification efforts. The development of many diversification activities in countries experiencing shortages of skilled labour is only possible with the employment of expatriate personnel (fisheries in Mauritania or mining in Niger) and the resulting loss of a significant part of gross export receipts. In Zambia the lack of refrigerated storage near airports has constrained the development of the potentially lucrative fruit export industry;[13] the expansion of the export fishing sector in Mauritania and Mozambique has also been limited by the lack of adequate storage facilities.[14] Even in many relatively economically advanced developing countries, like Mexico, the poor state of infrastructure is considered one of the most critical constraints on diversification and economic development - in the late 1980s the port of Houston in the United States handled more Mexican traffic than all Mexican ports put together.[15] Not surprisingly, countries with relatively developed infrastructure have a significant advantage over others with regard to increasing their share in international markets - the availability of well developed and sophisticated transport facilities was one of the major advantages that allowed Brazil to become the leading exporter of concentrated orange juice.

31. Barriers to access to markets of developed countries may discourage diversification in primary commodities with significant comparative advantage, as happened in the case of Mexican avocadoes, which are much cheaper than the Californian ones but are banned from entry to the United States market for sanitary reasons. On the other hand, preferential access to markets gives beneficiary countries a competitive edge over other suppliers and may provide an important reason for export of non-traditional products to specific markets: export diversification in Jamaica, Kenya and Ethiopia has been mainly into commodities on which EC protectionism was particularly strong and, hence, where the Lomé preferences were most significant.[16] However, the role of market access conditions, though not negligible, is not overriding: palm oil and soyoil industries in Malaysia and Brazil facing protectionist barriers in industrialized countries have successfully adapted their output and switched to non-traditional markets in developing and East

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[13] R. Baban, et al., p. 20.

[14] The Economist Intelligence Unit Country Profile on Mauritania, 1990.

[15] Financial Times, 25 October 1990.

[16] C. Stevens, p. 55.

European countries. Moreover, experience shows that some developing countries have succeeded in diversifying exports and penetrating markets protected by higher barriers, while others, facing lower barriers, have not.

32. In order to assure markets outlets, developing countries are beginning to participate in joint ventures with each other in the production and marketing of non-traditional commodities. Thus, for instance, Algeria and Congo have established a joint company to process and market wood and wood products.[17] A growing number of enterprises (Venezuelan aluminium producers, Indonesian and Thai tuna fish companies) are diversifying vertically, obtaining direct access to distribution networks in overseas markets, including markets of other developing countries. A Malaysian palm oil exporting firm, facing growing competition from more efficient exporters from Indonesia and Thailand, has built a refinery in Egypt and is studying similar investments in other developing countries which buy Malaysian palm oil.[18]

C. Government policies and supportive activities

33. Supportive actions by national Governments and their co-ordinating role are of crucial importance for the viability of diversification efforts. Governments need to provide a delicate interplay of sound macro-economic management and specific supportive services, creating an environment favourable to diversification activities. Examination of experiences of both developing and developed countries which have been successful in export diversification (for example Brazil, Colombia, India, Mexico, Malaysia, the Republic of Korea, Mauritius, Australia and the United States[19]) have demonstrated that conscious and coherent efforts by the Government, usually aimed at providing support to private entrepreneurs, play an essential role. Moreover, in many developing countries, private entrepreneurs are often not able to implement large- or medium-scale diversification projects, especially those with export-oriented activities, without government assistance, because of limited access to external finance and lack of experience, particularly in the export marketing of non-traditional commodities.

1. Economic policy environment

34. Evidence in the various country studies confirms that the creation and maintenance of an appropriate economic environment is critical for successful export diversification. This includes a set of carefully crafted macroeconomic policies and measures that are conducive to growth of investment and expansion of export capacity and that usually are not explicitly designed to support commodity-based diversification.

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[17] UNCTAD, "Multinational enterprises of sub-Saharan Africa - analytical summary" (UNCTAD/ECDC/201), 1989, paras. 307- 322.

[18] International Herald Tribune, 20 June 1991.

[19] See, for example, TD/B/C.1/AC/2, 1986.

35. Probably the most important macroeconomic variable influencing diversification and growth of export earnings is the real exchange rate. A review of country evidences suggests that a devaluation of the exchange rate, provided it is sustained in real terms and not eroded by inflation, can help an expansion of exports in countries where other constraints to diversification are not binding. When developing countries allowed their real exchange rate to become substantially over-valued, as in Malaysia at the beginning of the 1980s or Chile in 1979-1982, their export performance suffered until the rate began to depreciate. In Kenya, the period of rapid growth in horticultural exports coincided with a gradual and substantial devaluation of the national currency, which led to a real depreciation of 28 per cent between 1985 and 1988.[20] On the other hand, in other countries, especially highly commodity-dependent ones (e.g. Malawi), diversification into non-traditional commodities was not stimulated by real depreciation, in part because other obstacles were not overcome. Although the maintenance of a realistic exchange rate is fundamental in ensuring international competitiveness of national exports, this and other adjustment measures related to liberalisation, including decontrol of foreign exchange allocations, have not on their own always led to an automatic or rapid increase in non-traditional commodity exports.

36. As the development of diversification activities necessitates both local and foreign investments, Governments play an important role in promoting these investments by defining an investment regime, including sector-specific incentives. However, investment decisions of foreign companies usually depend not only on the introduction of direct investment initiatives, but also on the sustainable nature of investment promotion policies which, together with the macroeconomic and political stability of a country, provide an "enabling environment" for new investment.

37. In order to promote exports, many developing countries grant investment incentives, including inter alia tax holidays, sliding export taxes, subsidies, special prices on input supplies, concessions with regard to import duties and licences, the installation of export processing zones, and special regulations regarding the availability of foreign exchange and retention and remittance of profits. However, an export promotion package can only influence the decision of potential investors if its components are clearly defined and the investors are aware of their existence, which often seems not to be the case,[21] and therefore additional governmental efforts are required to diffuse appropriate information as widely as possible at home and abroad. The establishment of one-stop shops for investments, which provide information on rules, regulations and incentives with respect to investments and make it possible to simplify bureaucratic procedures, has been successfully used in many countries.

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[20] Stevens, C., "Kenya. Broadening the range of agricultural exports", The Courier No.127, 1991, p.70.

[21] For example, according to a survey conducted in Ghana, most companies, including export firms, were unaware of the existence of many components of the export incentives package. See C. Jebuni et al, p.37.

38. Along with general export promotion measures, many countries provide special incentives to non-traditional products. In Latin America, for example, non-traditional crop promotion programmes began in the early 1970s in Chile, Colombia and Mexico. In the mid-1970s Brazil also started to provide incentives to its newly established citrus and soybean crops and it was followed by many other countries of both Latin and Central America: Costa Rica, for instance, was offering tax holidays and export subsidies to producers of export-oriented non-traditional agricultural products.[22] These types of supportive policies have significantly contributed to the beginning and fast growth of production of a number of non-traditional and processed commodities. In Malaysia, generous government incentives offered since 1970 in order to incourage downstream processing of palm oil, in particular an exemption of palm oil products from some to all export duties, depending upon the degree of processing, have led to substantial palm oil refining. While in 1960 Malaysia did not refine any palm oil, in 1985 the country already operated 37 refineries, including enterprises fully processing palm oil into consumer products.[23]

39. Incentives to diversification into specific, in particular processed, commodities can be provided by government export marketing regulations, which are implemented through the imposition of restrictions or bans on exports of raw materials (such as those used for timber) or sliding export taxes (used for palm oil). One of the most spectacular examples of stimulating processing activities by means of imposing restrictions on raw material exports and granting tax incentives to processing activities concerns Indonesia, where since the late 1970s the government policy of forcing timber exporters to switch into plywood and sawn timber has produced results faster than expected. In 1982 the share of log exports in the total log production of the country fell to 22.5 per cent, compared to 70 per cent in 1979.[24]

40. Government policy in terms of conditions of credit and access to it by local entrepreneurs is also very important. The allocation of subsidized credits and the creation of special credit lines, both for general export-related activities and for specific non-traditional sectors, have been used as important stimuli to diversification in a number of countries. This source of credit is of particular importance to small and medium-size enterprises, which are usually at a disadvantage regarding the acquisition not only of foreign but also of national capital loans because of the high cost and risk involved in this type of lending. In many countries, an additional obstacle to access to credits consists of the demand by banks for excessive collateral, which most small-scale and new exporters are unable to provide. This obstacle may arise even in cases when the banks are underwriting loans from international and regional financial institutions to small national entrepreneurs. For instance, the small-scale enterprise assistance fund provided by the World Bank to the Ghanaian Government in 1989 remained practically unutilized two years later due to the inability of entrepreneurs to contribute at least 25 per cent

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[22] C. Arnade, p. 1.

[23] J. Pletcher, p. 628.

[24] UNCTAD/ST/CD/2, para. 133.

of the cost of the project and the reluctance of commercial banks to contribute 10-15 per cent of enterprises' investment needs from their own resources.[25] In order to avoid these kinds of problems, the Bolivia Export Foundation was created in 1991 to operate (with World Bank and Dutch government financing) as a private entity, providing risk capital for small farmers to develop selected non-traditional agricultural export products. This institution was created in parallel to other investments and supportive initiatives for agriculture, provided with the help of generous aid programmes aimed at crop substitution and stamping out growing of coca in Bolivia. As a result, wheat production in the country has increased substantially, sugar and soyabean exports have more than doubled and farmers have begun cultivating non-traditional products such as flowers, which they are exporting to the United States market.[26]

41. Another effect of the limited savings potential is that the Government often becomes the agent for accumulating financial resources. Besides the practice of funding diversification projects from oil revenues, several countries have successfully promoted these projects through special funds, financed in particular by taxes and other receipts linked to exports of traditional commodities. The provision of export credit finance, in adequate volume and at reasonable cost, is another important area of institutional support.

42. The selection of export sectors to benefit from investment incentives and other supportive measures has to be carefully evaluated by Governments. Apart from the risk of giving rise to accusations of unfair subsidisation by competing or importing countries, such measures may artificially stimulate inefficient exports. Moreover, the provision of government support to specific commodities which compete with other export products may negatively affect the competitiveness of the latter. This may be evidenced by the example of Costa Rica, which is facing labour shortages for the harvesting of coffee due to the movement of labour to government-promoted labour-intensive strawberry production.[27]

43. As far as producer price policies are concerned, their effect on diversification into new exports is often difficult to assess, since official price controls existed mainly for major traditional export commodities. The low levels of real producer prices for key traditional exports due to pricing policies of state marketing agencies have, possibly, stimulated investments in non-traditional activities in the country in question or in the same products in other countries where they may be considered non-traditional,[28] while the improvement of producer prices as a

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[25] D.K. Bedi-Bella, "Ghana. Diversifying the export base - problems and strategies", The Courier, No. 127, 1991, p. 82.

[26] Financial Times, 18 July 1991.

[27] C. Arnade, p. 2.

[28] For instance, in the mid-1980s Brazil and India increased their share on the market of cashew nuts due to a sharp fall of exports from the United Republic of Tanzania and Mozambique as a result of low producer prices and other adverse factors.

result of changes in these polices has provided an incentive mainly for the rehabilitation of traditional exports.

44. In Colombia the import-substitution economic development strategy which was implemented in the 1970s and gave little attention to exports was replaced in the mid-1980s by a major economic adjustment programme, which eventually led to the opening up of the economy and creation of a macro-economic environment favourable for export-oriented activities. Policy decisions are taken by the Government in consultation with a relatively well-developed private sector, and in the current economic programme the development of exports, especially of non-traditional ones, is given high priority. The goal of diversification out of overdependency on coffee has for a long time been part of government economic policies. In order to funnel resources into the development of other sectors, a number of diversification funds were successfully established. The largest of them, the government-administered Fund for Development and Diversification, has been used for the promotion of various non-traditional agricultural exports and has been financed by taxes on coffee exports, other contributions from coffee producers, and direct government allocations and external loans. The highly overvalued real exchange rate of the peso in the 1970s started to depreciate in the mid-1980s, which made Colombian exports more competitive and stimulated, in particular, the growth of non-traditional exports. However, during the following years the surplus in the country's current account, coupled with a large foreign exchange inflow resulting mainly from illegal exports of drugs, pushed the local currency up and created problems as exports became less competitive. During the 1980s non-traditional exports benefited from financial incentives, in particular the reimbursement of indirect taxes, as well as from subsidized input supplies and subsidized credit programmes, which were replaced later by credit lines for export-related activities. Exports of unworked wood are banned, while exports of semi-processed coffee started recently after the lifting of the ban on exports of this product, originally destined to satisfy demand on the domestic market.

45. In the Solomon Islands, in 1992 the Government held consultations with the IMF and the World Bank but so far has not reached an agreement on a structural adjustment strategy, which was to include devaluation of the local currency and reduction of interest rates and of government expenditures, and has only recently embarked on a more modest programme aimed at reducing the size of the public sector. Despite gradual depreciation of the local currency since 1989, the maintenance of high interest rates to reduce pressure for further devaluation does not provide the environment conducive to increasing private sector investment in export industries. However, the country has started to introduce measures to promote foreign investment and export of non-traditional commodities: it now has effective legislation to support production and exports of these products. Emphasis is being placed on attracting foreign investors to the commodity processing and mining sectors, and the Foreign Investment Board was recently established to provide a one-stop shop for such investors. The Government has imposed legislative requirements defining the minimum percentage of timber to be exported in processed form which are, however, far from being complied with.

46. Macroeconomic policies applied since 1980 under structural adjustment programmes in Senegal, though contributing to a certain liberalisation of the country's traditional protectionist

policies, have to some extent hindered the diversification and development of export activities, in particular by contributing to the reduction of government expenditures on export support services and facilities, raising interest rates and restricting access to credit by the private sector. Diversification away from groundnuts was an important element of government policies in the 1960s and 1970s, which promoted primarily the development of the cotton, fisheries and phosphate sectors. In the 1980s an export subsidy scheme was adopted which provided support to specific and often revised lists of products (initially canned fish, fertilizers, shoes, textiles and agricultural equipment) in order to increase their exports, while import and export procedures were simplified. However, in several cases the Government had to halve export supports and impose temporary taxes on export sectors in order to reduce budget deficits. Moreover, the elimination of input subsidies, especially for fertilizer and insecticides, has discouraged investors in export-oriented agricultural production. At the same time a number of diversification activities, in particular diversification into rice and wheat production, were encouraged within the framework of import substitution and protectionist trade policies. The overvaluation of the CFA franc, which is pegged to the French franc, is claimed to penalize Senegalese exporters of non-traditional products, in particular of processed agricultural commodities and horticultural products, but for industries depending on imported production inputs this seems to be of less importance than other constraints.

47. After independence, Cameroon followed import substitution development policies, supported by protectionist measures, which resulted in the creation and maintenance of inefficient activities and high internal prices. This policy was limited mainly to products of mass consumption and was followed without adequate co-ordination with neighbouring UDEAC countries. For example, the development of import-substituting footwear industries in other UDEAC countries led to the Cameroonian Bata shoe plant losing most of its exports and it was closed down in 1989. The structural adjustment programmes which started in 1988 were not directed at the development of export-related diversification activities in Cameroon: they were focused on domestic prices and import liberalization and the restructuring of the banking system and of the agribusiness chains of traditional export commodities. A recently adopted new investment code provides incentives to foreign investments through a one-stop-shop institution and promotes natural-resource-based value-adding activities with some export orientation. Despite the successful restructuring of the banking system, the problems of access to and the high cost of credits for investment and export purposes still constitute an obstacle to diversification into export-related activities.

48. In the mid-1980s, the Government of the United Republic of Tanzania started to adopt a package of structural adjustment measures, supported by the IMF and the World Bank. The implementation of these measures resulted in the partial removal of exchange rate overvaluation and external and domestic trade liberalisation and initiated the restructuring of agricultural marketing, infrastructure and the financial sector. Although emphasizing the rehabilitation of existing productive structures, these measures also influenced the development of non-traditional productive and export structures. In fact the successive devaluations have had a greater impact on non-traditional than on traditional exports, since the former benefited from a relatively more liberalized marketing system, providing stronger incentives to producers. Many of the increased gains from exports relating to exchange rate adjustments were not transmitted to producers of

traditional crops but were absorbed by the single-channel marketing institutions. This stimulated some producers to switch out of production of export crops into food crops (i.e. from cotton to rice). A number of export-retention schemes introduced in order to stimulate exports, in particular of non-traditional products, have also contributed to a widening of the range of exports. However, it is recognized that in comparison to Kenya and Zimbabwe, the United Republic of Tanzania had a narrower spectrum of export incentives, and the main shortcoming of the existing schemes is their failure to integrate adequate financing mechanisms.[29] Cumbersome rules and a complicated system of processing documents still constitute a constraint on export development, despite the efforts of the Trade Facilitation Council. National financial institutions allocate credit primarily to large parastatals, while credit to other, potentially more efficient borrowers, and especially small and medium-size indigenous entrepreneurs, has been severely constrained and subject to very stringent collateral requirements.

2. <u>Support services and activities</u>

49. While sound macro-economic policies are a necessary condition, they are not sufficient to make diversification happen. A review of studies of country diversification experiences has demonstrated that the most critical element for this consists of specific government supportive measures. This can be illustrated by the contrast between the success of diversification into horticultural export commodities in Kenya, which benefited from a useful partnership between the Government and the private sector, and the problems faced in Senegal for the same products, which have yet to be overcome.[30] Many diversification activities are simply not feasible or sustainable without the provision of certain support services, either by the government directly or by encouragement of the private sector to undertake them. Such support services include the provision and maintenance of infrastructural facilities; resource assessments, which are usually undertaken by Governments through direct financing or the provision of contracts to private firms; information and analysis on actual and estimated future consumption of targeted commodities, domestically and on world markets, as well as an identification of possible target markets and their assessment; access to day-to-day market information; the instituting of quality standards; training facilities and research and development programmes.

50. The penetration and maintenance of identified new export markets is a complex problem, which requires government support. Although a number of non-traditional commodities from developing countries have been successfully marketed, the marketing area has often been

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[29] K.S. Mbatia, "Constraints to the growth of non-traditional exports,with particular emphasis on incentive schemes", report to the workshop on <u>Non-traditional exports: constraints to its growth and solutions,</u> Dar Es Salaam, 1993.

[30] Unlike in Senegal, in Kenya the public sector has actively assisted private producers and exporters in providing research, upgrading extension services to smallholders, establishing packing stations, licensing exporters, providing information on international markets, assisting in developing a system for allocating air cargo space and inspecting horticultural produce shipments.

relatively neglected vis-à-vis the production side. In order to become competitive on international markets, non-traditional exports need strong governmental measures to ensure that product quality is strictly maintained and, if required, upgraded over time. A review of country evidence shows that this has been achieved through a combination of different measures, including special quality improvement programmes, the establishment of an efficient grading system, the laying down of standards, gathering of information and licensing of producers and exporters, which may be implemented by various government commodity-specific or general export promotion institutions. Another important aspect is the provision of opportunities for training in production, management and marketing as well as in the collection and processing of information. Although many enterprises, especially large private ones, are able to provide on-the job training for labour and personnel, in most cases there is an ongoing necessity for additional training, especially for senior technical and marketing personnel, using various existing training schemes and facilities at home and abroad, provided by or accessible through the Government. Appropriate research and development to adapt foreign technologies to local needs, to create new technologies suited to local conditions and to develop and test new export products is of primary importance for encouraging enterprise initiative in diversification-related activities. The promotion by the Government of services in the area of maintenance of industrial equipment and supply of spare parts is also essential.

51. As, in many commodity-dependent developing countries, financial resources are lacking, while foreign private capital is difficult to attract, the success of diversification efforts is very much dependent on financial and technical support from the international development assistance community. Beyond the provision of investment resources for specific diversification activities, foreign financial and technical assistance is needed to create an environment conducive to private investment, including development of related infrastructure, human resources and various supportive activities provided either by the public or the private sectors, as well as for the whole set of pre-investment services, i.e. for the elaboration of diversification programmes and policies, resource assessment, pre-feasibility, feasibility and market studies and for the identification of economically viable projects attractive to foreign investors. The importance of foreign financial and technical support may be illustrated by the experience of Ghana, which in the 1980s was singled out in Africa for massive funding by the World Bank, IMF and bilateral donors as a model of a successful and willing low-income and commodity-dependent reformer. With foreign financial and technical support, the country was able to undertake, inter alia, major infrastructural rehabilitation projects (in the areas of transport, power, communication and water supply), which have played the major role in restoring an effective base of support services indispensable for export growth and diversification.

52. The provision of support services to the private sector at the beginning of the production chain, i.e., inputs, technology and training, is emphasized in current government economic policies in Colombia. The Colombian transportation system has improved in recent years thanks to government infrastructural policies, encouraging privatization of the system and providing necessary conditions for the development of private initiative. This has facilitated exports of many non-traditional and processed commodities, in particular flowers, fruits, clothing and leather goods. For instance, a special agreement signed with Venezuela in 1991 has provided Colombian exporters with additional air carge space, necessary to exploit fully the benefits of tariff

concessions for their flower and fruit exports to the EEC market. Significant investments for the development of infrastructure were provided within the framework of diversification programmes financed from the Fund for Development and Diversification, which also promoted diversification through research and development, and the creation of commercialization and price information networks for fruits, roots and vegetables. Government support structures have been developed in the area of export market promotion through Proexpo. Until 1991, when most of the support services provided by this organization were taken over by the Ministry of Foreign Trade, it played an important role in informing private entrepreneurs about export opportunities, arranging their contacts with potential buyers, adapting products to the exigencies of foreign markets and supporting promotion campaigns, in particular for Colombian fruits. For instance, in order to promote exports of leather products, Proexpo worked on improving their quality and raising productivity and has arranged contacts between producers and foreign clients. Other government organizations also participate in the creation of market information networks, organization of special seminars and penetration of new markets. The establishment of quality standards and the provision of information on international quality norms is the responsibility of the Foreign Trade Council.

53. In the Solomon Islands, government assistance for the development of the export sector has consisted mainly of the provision of investment incentives, with relatively less attention paid to providing support services. The lack of access to market information, as well as of adequate marketing and infrastructural support, constitutes a major constraint on the development of non-traditional exports. The failure of local fishermen to increase their returns through the utilization of the chain of fishing centres and depots built in the mid-1980s with foreign assistance was due mainly to the lack of regular access to and knowledge of export markets, which the provincial governments, responsible for the upkeep of the centres, could not provide. Moreover, because of the lack of recurrent funding, the facilities of the centres have not been adequately maintained and most of them now require rehabilitation. Government participation in marketing is limited to copra exports through the Commodities Export Marketing Authority. This authority controls quality, encourages higher quality of produced crops and has marketing and price stabilization functions.

54. As indicated in the preceding section, the reduction of government expenditures as a consequence of structural adjustment measures implemented in Senegal has significantly reduced the volume of government support for export activities in the areas of infrastructure, training, research and development, quality control and market information. For instance, apart from the establishment of the Airfreight Committee allocating airfreight capacity, the Government has not intervened to facilitate the production and export of horticultural products. The reduction of allocations for the traditionally important training support in the area of fishing has resulted in deterioration of training equipment and shortages of qualified personnel. Employment cuts and a salary freeze were reported to be affecting the effectiveness of the Senegalese Agricultural Research Institute. In contrast to exports of groundnuts and phosphates which benefit from marketing networks and the experience gathered over several years by two major parastatals, non-traditional exports, and especially fishery and horticultural exports, do not have adequate assistance in the area of marketing, adaptation to changing market conditions and requirements (mainly in Europe) and quality control. This has affected the quality of fish, which in turn has

resulted in restrictive measures being taken by some importing countries against Senegalese fish exports. The absence of a grading scheme rewarding producers for harvesting higher-value products, coupled with poor post-harvest handling, storage and transportation systems help explain the low grading of French beans from Senegal on European markets.

55. Diversification into non-traditional and processed export commodities in Cameroon is seriously limited by insufficient support services. The operations of the two principal government agricultural research networks - IRA and IRX - are undergoing serious difficulties. The lack of market information and the resulting poor assessments of market prospects have contributed to losses and consequent closure of parastatals in the sectors of fertilizers, shoes, and pulp and paper production. The dismantling in 1991 of the marketing parastatal (ONCPB) has led to the loss of marketing services and contacts. The new organization replacing the ONCPB has so far been unable to take over all its activities, in particular in the area of quality control and promotion, while the private traders who took over marketing activities have little or no experience in export promotion or price negotiations.

56. Extension services to export sectors are weak in the United Republic of Tanzania. After the termination of marketing operations by several crop-specific marketing boards, marketing intelligence and services are being provided on a commercial basis. This has been insufficient to compensate for the lack of experience of private exporters, who lack marketing skills, adequate market information and knowledge of market trends. Quality assurance and control are mostly left entirely to exporters, and the United Republic of Tanzania has experienced substantial losses due to low prices paid for some of its non-traditional exports (i.e. leather manufactures and ready-made garments) as a result of inefficient marketing and low quality.

57. Other developing countries provide additional examples of country-specific experiences with the provision of government support services. As Governments often face problems in meeting the high costs of infrastructural facilities, in certain cases they give preference in their policy initiatives to products requiring relatively smaller infrastructural expenses: thus, for example, in Nepal the Government is encouraging investments in high-value woollen carpets and garments. In this respect products which are storable and less susceptible to transit damage, such as canned fruits and vegetables, may have an advantage in comparison to fresh commodities when there are storage and transport constraints. In other cases problems related to transport bottlenecks can be solved by Government legislative measures. For instance, air freight rate regulations were relaxed in Thailand in order to provide cargo space for exports of orchids, while in Kenya the Government reduced the tax on aviation fuels in order to try to increase air transport space for non-traditional products.[31]

58. Governments' important role in the provision of market information can be illustrated by the establishment, with government support, of sophisticated centralized export information networks in South-East Asian newly industrialising countries, offering extensive market surveys

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[31] "Flowers and foliage: a blooming market", The Courier, No. 127, 1991, p. 69; C. Stevens, p. 26.

and feedback from consumers to producers. Insufficiency of information about external market potential, conditions, prices and plans of other suppliers has on many occasions been acknowledged as a major factor hampering the development of export-oriented activities, especially in respect to non-traditional and processed commodities, for example fishery exports from Nigeria.[32] As markets and marketing systems for these commodities are usually much less documented than for major traditional products, penetration of new markets for independent non-traditional exporters becomes more difficult. Moreover, many non-traditional exports have to be matched precisely to market demand, which differs from country to country and even from season to season. For instance, African suppliers of flowers to European markets use periods of the year when Israel, Spain, Portugal and Turkey cannot supply them. Another problem arises with access to information for products for which specifications vary widely among markets, as could be evidenced, for example, by variations in product preferences on major shrimp markets - EEC, Japan and United States.

59. An examination of experiences with export diversification into specific commodities for individual countries, especially in Asia and Latin America, points to the importance of joint efforts in the marketing area between Governments and private exporters. Chile's diversification away from copper owes much to the export promotion activities of the government organizations ProChile and Asexma.[33] Malaysian producers have increased their role on different markets thanks to active marketing policies of commodity-specific regulatory bodies.[34] Pescom, a government-owned company, has been successfully marketing Mozambique's prawn production in Europe and Japan.[35] Some of the more advanced Asian and Latin American developing countries have developed public/private strategies for the export of certain commodities (timber in Brazil, non-traditional agricultural products in Bolivia, fruits and shrimps in Colombia, aluminium, steel and non-traditional fuels in Venezuela, processed foods and marine products in India, minerals, processed timber and agricultural commodities in Indonesia, palm oil and cocoa in Malaysia, non-traditional exports in Pakistan, etc.). These strategies in most cases do not involve centralized marketing of the export product, but rather government institutional, educational and other supportive services for private marketing enterprises, similar to support given to commercialization efforts in developed market economy countries.

60. With respect to training, the co-ordination of private and public programmes and the establishment of appropriate training standards can be achieved through special bodies like, for example, the Industrial and Vocational Training Board recently created in Mauritius. As far as

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[32] Draft proposal for a technical assistance programme on strengthening of the external trade sector to be included in the UNDP programme 1992 to 1996 for Nigeria, Geneva, 11 February 1991, p. A12.

[33] Financial Times, 28 September 1988.

[34] J. Pletcher, pp. 632-634; UNCTAD/ST/CD/2, para. 129.

[35] Financial Times, 15 Jaanuary 1991.

the accumulation of additional funds for training purposes is concerned, a number of developing countries have acquired experience in imposing special levies on the wage bill of firms which, sometimes together with government contributions, have been used to finance specific training activities. For instance, expatriate labour employed in the plywood milling industry of Indonesia had to pay a levy, which was used by the Government to train locals in milling skills.

61. The importance of research and development for the success of diversification efforts is well established. A good example is the crucial role that research activities have played in the development of an important part of United States market-oriented vegetable production in Mexico from essentially a zero base at the beginning of the 1960s. Government support in this area may be provided in the form of specific programmes (such as the National Research Programme for soya, financed by the Brazilian Government, which involved more than 150 projects in various research centres and universities[36]), introduction of legal measures stimulating private sector research (research and extension in Mexico's vegetable crop production), or through specialized research institutions, usually established with government funding or under government auspices. A successful example is the work of the Malaysian Palm Oil Research Institute, responsible for applied research in palm oil technology and processing. Malaysia has also established institutes for rubber and forestry. Other examples include the tea institute in Malawi, phosphates and fertilizer institutes in Tunisia and India and the timber institute in Indonesia. Several developing countries have research institutions dealing with groups of commodities, which can also contribute to the promotion of specific non-traditional exports: the Food Research Institute in Ghana has recently initiated a project to cultivate mushrooms for local consumption and export. An active policy to stimulate research and development and to facilitate access to and adoption of foreign cost-reducing technologies often requires large financial resources. To address this problem, research activities could be co-financed and managed by the private sector either directly or indirectly through taxes and royalties paid by producers and exporters. For example, the activities of the Palm Oil Research Institute of Malaysia are financed by a tax on the exports of the palm oil industry.

62. Many exporters of non-traditional commodities from developing countries experience difficulties in meeting quality standards and individual market requirements at a reasonable cost. Furthermore, transport, storage, post-harvest handling and packaging are often not up to international standards. Poor quality control has inhibited export diversification efforts such as cotton and livestock exports from Ethiopia, exports of small livestock from Haiti or tea exports from several African countries. It may also contribute to a loss of markets, as can be evidenced by a deterioration of the market share of East African exporters of livestock in the Near East (from 50 to a mere 3 per cent within a decade starting from the early 1970s[37]) or by the inability of Zimbabwe to sustain leather shoe exports to European markets in the 1980s. Although problems with the quality of products and reliability of supplies are most common among small-scale producers, the example of smallholder horticultural production in Kenya shows that, when

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[36] UNCTAD/ST/CD/2, para.92.

[37] TD/B/C.1/312, para. 74.

accompanied by efficient producer support services, small- scale production can ensure both high quality and large and stable quantities of supplies. In the case of high-value non-traditional agricultural commodities, contract farming, which was successfully used, for instance, in the case of pineapples in Thailand and the Philippines or palm oil in Malaysia, can also increase incentives for small-scale producers to meet the quality standards required by processors or exporters.

63. As far as diversifying out of crops used for illicit drug production is concerned, measures in support of the development of alternative agricultural activities, including those using similar production techniques (e.g. floricultural products), may be quite successful, especially if they are accompanied by large aid programmes (Bolivia), by the granting of preferences to new exports in consuming markets (Andean countries), and/or by the capacity of the local private sector to invest important amounts in the development of non-traditional activities (Colombia). However, the experience of Andean countries shows that the development of alternative agricultural sectors in a country does not necessarily stamp out cultivation of drug crops, which continue to be grown in remote and inaccessible areas where the implementation of crop substitution initiatives is very expensive and difficult.

III. MAIN FINDINGS AND POSSIBLE AREAS FOR FUTURE ATTENTION

64. The examination of the experience of developing countries which have succeeded in diversification efforts within the commodity sector and/or out of commodities shows that this success has been achieved primarily in high and middle-income countries that were able to embark on a self-sustaining process: once some diversification activities were successful, they were followed by further such activities, including horizontally into additional commodities and vertically into processed forms. This was possible because of a combination of different and often country-specific factors and conditions, both internal and external. An important finding is that, while certain basic factors such as natural resource endowment, geophysical and climatic characteristics and size of the domestic market of a country set certain limits to the development of diversification activities, these were not decisive barriers, but rather obstacles to be overcome or circumvented.

65. A common feature of the countries which have achieved results in realizing their commodity-related diversification opportunities is that they had a deliberate government policy of support and encouragement for the initiative of private investors, both domestic and foreign. These policies and measures helped to create an attractive economic and political environment for investors, to promote effectively national investment opportunities at home and abroad and to mobilize both domestic resources and adequate financial and technical support from the international community. Diversification efforts of developing countries also require support from the international community in the form of the removal of obstacles to access to markets and the avoidance of imposition of new trade barriers of any sort. This, for its part, can help to attract export-oriented investment in the production of non-traditional and processed commodities.

66. It is very clear that the various factors, conditions and actions influencing the viability of commodity-related diversification activities are strongly interrelated. Market access is a prerequisite for entering and maintaining external market outlets, but it needs to be accompanied by access to adequate technical and financial assistance for developing viable export-oriented projects. Similarly, investment incentives at the national level must be supplemented by other necessary support services, such as information, infrastructure etc., as well as by an appropriate exchange rate policy. Thus, macroeconomic conditions such as those being prescribed in structural adjustment programmes may be a necessary, though not a sufficient condition for diversification activities to develop.

67. Areas and sectors suitable for diversification, as well as the importance of diversification-related factors and conditions, vary among countries in accordance with their particular situation. There is obviously no unique blueprint for promoting diversification efforts, although some common problems have been identified in which exchange of experiences can be useful. However, the way forward seems to lie in detailed efforts to assess the diversification prospects of individual countries or groups of countries and to provide specific assistance to diversification efforts.

68. One initiative in this direction was undertaken by UNCTAD in 1992 through its implementation of a pilot project intended to promote local processing in highly commodity-dependent developing countries. This project, financed by the Government of Japan and by UNDP, was developed in co-operation with relevant international organizations and currently involves two beneficiary countries - Cameroon and the Solomon Islands. Its implementation involves several steps. First, it envisages the provision of an independent and realistic assessment of the commodity sector of the beneficiary country concerned in terms of its vertical diversification potential. Second, an assessment is undertaken of the technical viability of potential projects and the development of project proposals, with due account taken of existing marketing opportunities. Third, there is a consideration of follow-up actions by means of arranging investments and technical assistance, as well as by identifying appropriate government policies and other supportive measures to be implemented. Preliminary indications show that the project coordinating mechanism could profitably be used to help other commodity-dependent developing countries and that, logically, the assistance provided could be extended to promote not only vertical, but also horizontal diversification in the commodity sector.

69. Another area of assistance could involve facilitating the exchange of experience among Governments in respect of diversification in specific commodity sectors, particularly in connection with reviewing their commodity, sector-specific and related support services policies, as well as their ways of interacting with the private sector. UNCTAD is also undertaking a project in this field with support from Australia and Israel.[38]

70. The issue of reducing dependency on primary commodities has been a topic for research and discussion in UNCTAD practically since its inception and particularly between 1966 and 1975, when it was taken up at almost all sessions of the Committee on Commodities; between 1979 and 1987, when the issue was considered by the Committee in terms of processing, marketing and distribution; and again since UNCTAD VII, when new orientations were given to the work on diversification based on discusions of five issue areas. However, success in reducing commodity dependency has been well below expectations. The intention of providing international support to efforts aimed at achieving diversification and gradual reduction of excessive commodity dependency was reiterated in the Cartagena Commitment adopted at UNCTAD VIII. One possible next step could be for the Standing Committee on Commodities to draw on the analysis of national experiences to identify ways of implementation of efficient forms of assistance for developing countries in achieving diversification, including means of enhancing co-operation for institution-building and promotion of entrepreneurship.

[38] For more on this and the preceding initiatives, see UNCTAD, "Technical co-operation in the field of commodities: identification for consideration of areas in which technical co-operation should be strengthened", TD/B/CN.1/12, 1993.

Annex I

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Annex II

Dependency of countries on commodities for export earnings

(Number of countries)

	Average 1988-1990						Average 1979-1981					
	Total Commodities[a]			Primary Commodities			Total Commodities[a]			Primary Commodities		
	Percentage of commodities in total export earnings											
	>70	70-50	<50	>70	70-50	<50	>70	70-50	<50	>70	70-50	<50
OECD[b]	6	2	15	-	1	22	6	2	15	-	1	22
Central and East European Countries	-	-	8	-	-	8	-	1	7	-	-	8
Africa												
North Africa	5	-	-	1	-		5	-	-	3	2	-
sub-Saharan Africa	42	-	-	30	7	5	41	1	-	31	6	5
Developing Asia and Pacific												
Oceania	8	-	-	4	2	2	8	-	-	5	3	-
West Asia	7	3	-	5	1	4	9	1	-	8	-	2
South and South East Asia	10	2	3	-	5	10	13	1	1	5	3	7
Developing America												
Caribbean	8	3	-	3	2	6	7	3	1	2	5	4
Latin America	18	2	-	7	4	9	20	-	-	7	7	6

Source: UNCTAD secretariat calculations. Includes all countries for which consistent data are available.

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a/ Includes primary, semi-processed and processed commodities.

b/ Data for Belgium and Luxembourg are reported together.