Briefing Paper 1

PRODUCTIVE CAPACITY

A primary goal of the least developed countries as they approach the Istanbul conference is to build a broad base for economic stability and self-sufficiency, so that populations can emerge from poverty and societies can strengthen the rule of law and cope with climate change, global recessions and other external shocks.

The current state of economic affairs in these countries is characterized by:

- dependence on natural resources and single commodity exports;
- low level of technology and high vulnerability to external shocks;
- a productive base constrained by low value addition and retention and low competitiveness on the global market;
- dependence on low-productivity agriculture;
- a small industrial base, also plagued by low productivity, and a very limited service sector.

Some keys to these economic deficiencies in otherwise very diverse countries — scattered across three continents and occupying islands in three major seas — may be found in several notable common factors.

Sixteen of the 48 LDCs are landlocked, generating higher costs for imports as well as reducing export competitiveness. Nine occupy small islands, a situation that similarly hampers development because so many key items must be shipped in or out by sea.

Except for Afghanistan, Bhutan and Nepal to the north, and Lesotho to the south, the LDCs are situated within the tropical band stretching from the Pacific islands through South Asia and sub-Saharan Africa and on to Haiti. These equatorial regions tend to be hot and either very dry or wet, with volatile weather and enervating tropical diseases. According to the World Bank Development Indicators, of the top 20 nations vulnerable to tuberculosis, 12 are LDCs, and so are 14 of the 20 countries most vulnerable to malaria.

Finally, the LDCs have been prone to civil conflicts. Currently, eight of the UN's 15 peacekeeping operations are based in LDCs, and the 2011 *Report of Eminent Person*s acting on behalf of the LDCs calculates that these nations have produced above or close to 60 per cent of the world's refugees over the past decade.

BUILDING THE ECONOMIC BASE

The period since the adoption of the 2001 Brussels Programme of Action on the LDCs has seen a strong acceleration in economic growth, according to the Secretary-General's report on implementation.

During 2002-7, growth of real gross domestic product (GDP) surpassed the 7 per cent per annum target set in Brussels, a marked improvement over the previous decade's average growth rate of below 4 per cent. Even in the aftermath of the world financial crisis, LDCs continued to grow at rates above global averages.

Evidence points, however, to the large role played by oil and other raw commodities in growth and to the failure of employment rates and poverty reduction in the LDCs to have advanced apace with growth. And despite strong growth, the total 2009 GDP of the LDCs — $548 billion by World Bank figures — is dwarfed by totals of $4.6 trillion for the lower-middle and low-income countries combined, and $58 trillion worldwide.

Nevertheless, the LDCs do have some assets in their bid to increase productive capacity:

- Demographics indicate that the LDCs have a young and dynamic workforce. Those who work overseas show a strong propensity to send home remittances and hold the potential to repatriate with cutting-edge skills and experience.
- While commodity dependence is a traditional weakness, the apparent long-term rise in commodity values and arable land can help to provide injections of cash and capital that potentially can fuel capacity-building.
- The vast biological diversity within the LDCs is itself an economic asset, and many of these nations can take advantage

Shipyard in Bangladesh | Photo: The World Bank/Thomas Sennett

of wind, sun and waves to develop alternative energy sources.
- South-South cooperation is on the rise, in the form of trade, investment assistance and, most of all, successful sharing of experience between LDCs and other, more dynamic economies from the developing world.

For more information on inputs to productive capacity, see additional *Briefing Papers* on aid, investment, agriculture, trade, climate change and essential services.

INFRASTRUCTURE AND TRANSPORT

"Improvements in physical infrastructure and transportation both at the domestic and regional levels are particularly important to making globalization work for the LDCs," the Secretary-General's report states.

In this area, progress has been sketchy. The total road network expanded in 13 least developed countries, but declined in five. Air and rail links have not advanced decisively either. Most LDCs continue to experience frequent power outages, severely hampering their ability to meet public needs and attract investment.

But access to mobile telephony, aided by private sector investment, has markedly increased. Between 2000 and 2008, the reach of fixed telephone lines increased from 0.5 to 1 per 100 people, whereas mobile coverage ballooned from 0.3 to 20.9 per 100, according to the International Telecommunication Union.

GENERATING DOMESTIC FINANCES

One leverage point in improving productive capacity lies in amassing domestic resources that governments can deploy for infrastructure and human resource development.

Taxation is one of the keys to mobilization of domestic resources.

On average, LDCs' level of tax revenue per GDP is two to three times lower than in countries belonging to the Organisation for Economic Cooperation and Development (OECD), and less than half of the average for upper-middle-income countries, according to a statement from a global meeting of finance ministers (Lisbon, 2010). Studies on the optimal level of taxation for development suggest that revenues in the vicinity of 25 per cent of GDP are desirable, but the LDCs are averaging only about 10 per cent.

Many commodity-exporting LDCs have seen sizable increases in revenues as the prices of these commodities rose over the past few years. However, revenue from taxing extractive industries is even more volatile than tax revenues in general, and decidedly pro-cyclical, i.e., rising in good times but declining during recession, when revenue is most needed. Dependence on taxing extractive industries, moreover, often allows governments to feel they can shy away from more politically demanding revenue sources, such as corporate and personal income taxes.

Some least developed countries have taken steps to improve compliance with tax regulations and collection of arrears, and to extend value-added taxation. There has been substantial progress in tax administration, according to the finance ministers. The time needed to prepare and pay taxes per year is, on average, not much higher in LDCs (258 hours) than in OECD countries (216 hours), according to the World Bank.

Another option for increasing productive capacity is for governments to work through partnerships with domestic or international businesses.

Private-public partnerships are recommended in areas such as infrastructure, energy, telecommunications and transportation, as well as for improving efficiency in financial services. Also highlighted by finance ministers as particularly promising are partnerships in education, public health and social services. Such activities can not only bring in new capital, but allow for technology transfer and capacity-building for domestic enterprises.

While increased generation of financial resources is expected among the LDCs, they are starting from a low baseline of a 10 per cent domestic savings rate. To generate rapid progress in standards of living and productive capacity, increased international cooperation remains essential.

The Lisbon report of finance ministers indicates that the currently limited tax administration capacity and narrow tax bases in the LDCs can only be remedied with many years of sustained effort. Donors should therefore regard domestic reform and resource mobilization as a complement to, rather than a substitute for, development aid.

Issued by the UN Department of Public Information – DPI/2569 A – April 2011

UN Office of the High Representative for the Least Developed Countries, Landlocked Developing Countries and Small Island Developing States

UN-LDC IV