Major roadworks

Developing countries face major vulnerability challenge

Vulnerability, with its facets of exposure and dependence, represents a major challenge for the sustained and beneficial integration of developing countries into international trade, the UN Conference on Trade and Development (UNCTAD) has said, writes ***Kanaga Raja**.

According to an UNCTAD Note presented at the eleventh session of UNCTAD's Trade and Development Commission, as countries open up and deepen their integration into the global economy, their economies become interdependent but also exposed to external risks.

Combined with the absence of alternative means, the process of integration could lead to a state of vulnerability for countries dependent on particular forms of trade, finance, products, markets, suppliers, transport routes and infrastructure, due to their natural endowments and specialization patterns, which could have profound implications for their economic welfare and development paths.

There is a need to effectively address the causes and effects of multi-faceted vulnerabilities, including the imminent threats posed by climate change, to buttress economic resilience for sustainable development, said UNCTAD.

In some opening remarks at the session on 25 November, Dr Mukhisa Kituyi, the Secretary-General of UNCTAD, said that "we are seeing a diverse set of challenges today." In this context, he pointed to rising sea levels and violent hurricanes compromising the very existence of SIDS and coastal communities, to transport and shipping links and the vulnerability of small islands and landlocked developing countries to fluctuating commodity prices with major dire consequences for many developing economies, and to rising debt that is hindering the ability of nations to finance development and build greater climate resilience.

"And related to these challenges, we see persistent inequalities translating into an autumn of discontent including in countries particularly in middle income and high income countries. From as diverse a place as Lebanon to Chile, from China to Bolivia, South Africa to France and now the latest Colombia, we are seeing a new uncertainty in the discontent enveloping the world."

But in the world today, this set of challenges is even additionally complicated by the increasing challenge of trade tensions and unilateralism on the international platform, he said. The impact of the current trade tensions on the multilateral trading system further threatens the vulnerable countries, he added.

The UNCTAD note stated that small island developing States (SIDS) are a heterogeneous group of countries.
Despite being "small" and islands, the size and economic profile of these countries differ significantly on several measures. For example, as a group, SIDS include nine least developed countries (LDCs) and extend to all income categories, including six countries classified as high income by the World Bank.

Despite the asymmetries, SIDS face special development needs arising from their unique vulnerabilities, including in the context of achieving the Sustainable Development Goals (SDGs). "Smallness" carries implications of scarce land areas and limited labour and capital for agriculture and manufacturing production, and, consequently, high production costs and low output volumes.

The small market size of SIDS does not allow these countries to benefit from economies of scale, which severely constrains their productive and export capacities, with knock-on effect on the entire economy. Insularity often implies remoteness from major markets, import sources and transport hubs.

The transport and mobility costs for SIDS are high, as they are excluded from major transport networks. Located in the Caribbean Sea, the Mediterranean Sea, the South China Sea and the Atlantic, Indian and Pacific Oceans, SIDS are at high risk of extreme weather events and natural disasters and of the effects of climate change in the long term.

SIDS are generally open to and highly dependent on international trade, said UNCTAD. As their domestic markets cannot afford large-scale industries subject to economies of scale, SIDS tend to lack competitive export products that could drive an entire economy. Conversely, they tend to rely heavily on imports of energy and a wide range of food, capital and consumer goods to fuel their economies and meet subsistence needs.

The trade-to-GDP ratio reaches 100 per cent in half of these countries and is above 90 per cent in 75 per cent of SIDS. Consequently, SIDS register large current account deficits. In 2016, SIDS ran current account deficits of 5.8 per cent of GDP on average, reaching 20 per cent in some cases. Persistent deficits translate into external finance needs, which have mainly been addressed through external debt.

Debt dependence and sustainability are indeed a common and longstanding issue in SIDS, particularly in the Caribbean. In 2014, the debt-to-GDP ratio of SIDS stood, on average, at 57 per cent of GDP; the majority of this debt-to-GDP ratio (45 per cent) was external. While concessional loans are vital sources of development funding, the share of official development assistance flows to SIDS steadily has declined as the relatively high income level of many SIDS has made them ineligible for concessional finance. In the absence of concessional finance, non-eligible SIDS have relied heavily on private finance and capital markets. This has exposed them to market volatility and the risk of reversals in financial flows.

Lack of economic diversification, and dependence on a few export commodities and markets, has gradually compromised the participation of SIDS in international trade. Since 2000, their share in world merchandise exports fell from 0.15 to 0.10 per cent. Exports of traditional cash crops such as coffee, fruits and sugar, as well as apparels, dwindled as new competition emerged and preferential market access conditions gradually eroded. This has happened despite the continued importance of these products, for several SIDS, as a source of foreign exchange.

With geographical conditions discouraging agriculture and manufacturing activities, many SIDS have become remarkably focused on services, UNCTAD noted.

Uncertainties regarding the functioning of the multilateral trading system created by heightened trade tensions are therefore a cause for concern for SIDS. These countries have major stakes in a robust and functional rules-based system. The recent debate on World Trade Organization reform to modify the design of the special and differential treatment principle could have an important bearing on SIDS. At issue is whether or not to limit the eligibility for special and differential treatment provisions by the application, inter alia, of the criterion of a country's per capita income.

This is a reminder of the important policy question of how the special vulnerabilities of SIDS should be measured and addressed in international policy-making processes, said UNCTAD.

Commodity dependence

According to UNCTAD, primary commodity-producing countries that face declining and often volatile prices on the one hand, and have to import manufactures produced in high-wage countries and in industries where entry barriers are high, on the other, could suffer from decreasing terms of trade and be trapped in a state of commodity dependence characterized by an "unequal exchange" with commodity-importing industrialized nations.

The most recent UNCTAD data indicates that 102 countries were commodity dependent (at least 60 per cent of the value of their merchandise exports is accounted for by commodities) in 2013-2017, an increase from 92 in 1998-2002. Two thirds of developing countries' exports are dependent on commodities. Commodity dependence is almost exclusively a developing country phenomenon that especially affects vulnerable country groups. It affects 85 per cent of LDCs, 81 per cent of landlocked developing countries and 57 per cent of SIDS. Geographically, 89 per cent of countries in sub-Saharan Africa are commodity dependent, which is the hardest-hit region.

Empirically, evidence shows that commodity dependence can have a negative impact on development through terms-of-trade shocks and price volatility, with macro and micro effects, particularly at the household level for small-scale farmers, miners and the poor. At the macroeconomic level, commodity-dependent developing countries are vulnerable to negative commodity price shocks and commodity price volatility.

The impact of these fluctuations can be amplified when commodity prices exhibit a high frequency of sharp positive shocks (peaks) and long bottoms, or downward trends. These price shocks and volatility are detrimental to exporters. For example, average commodity price levels in 2013-2017 were substantially below their peak of 2008-2012. This contributed to an economic slowdown in 64 commodity-dependent developing countries, with several going into recession. As growth decelerated, the fiscal situation in many commodity-dependent developing countries deteriorated, resulting in the accumulation of public debt, often in the form of an increase in external debt. The external debt of 17 commodity-dependent developing countries increased by more than 25 per cent of GDP between 2008 and 2017.

Also, a commodity export earning boom could lead to real exchange appreciation, which in turn creates a situation of inefficient resource allocation and a loss of competitiveness of non-commodity sectors, often described as "Dutch disease", said UNCTAD. While the share of natural resources in GDP has been found to have a positive impact on growth performance, volatile commodity prices lead to volatile output and investment, which in turn depresses per capita GDP growth.

At the microeconomic level, export earnings uncertainty has an impact on savings and investment decisions. In developing countries, investors are often risk-averse and face liquidity constraints amid poorly functioning capital markets. This could force economic agents to make precautionary savings. Through this channel, income instability could negatively impact investment. Risk occurring from instability in export revenues is likely to modify long-term growth, as economic agents could refrain from investing in technical progress.

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For example, during the period of structural adjustment programmes implemented in Latin America and Africa in the 1980s and 1990s, marketing boards and stabilization funds for agricultural commodities were dismantled, while export taxes were removed. The phase-out of marketing boards, by removing price guarantees, increased exposure of these region's countries to international markets shocks.

Public services were abandoned, without private sector takeovers. This led to production instability amid variable yields and product quality. Farmers reduced adoption of new technologies and control of agricultural processes, leading to lower product standards, said UNCTAD. UNCTAD found that the countries most vulnerable to climate change are commodity-dependent developing countries (including many SIDS and LDCs). They are also among the countries least prepared to adapt to climate change; thus, climate change reinforces the need for economic diversification and transformation in commodity-dependent developing countries.

Transport and logistics are the backbone of globalization. They drive international trade and service value chains, while enabling deeper market integration.

However, this strategic sector is increasingly at the forefront of the vulnerability debate. Its heightened exposure to disruption factors undermines the ability of transport and logistics to effectively support a trade-led sustainable development path.

Over recent years, multiple, interconnected concerns have arisen that have heightened the vulnerability of transport infrastructure and transport and trade facilitation services. These concerns include varied risks that span economic, social, environmental, regulatory, technological and market-related factors.

Concrete examples include the rising geopolitical risks, environmental degradation, fossil fuel dependence, climate change, security threats, disruptive technologies, new demands on cross-border trade facilitation and cybersecurity. Many developing countries and LDCs are faced with persistent transport challenges that could be further exacerbated by heightened vulnerability. These include infrastructural transport deficits, limited connectivity to transport networks, lack of investment and of access to finance and prohibitive transport costs that weaken their trade competitiveness, economic development and social progress.

The vulnerability of transport and logistics is particularly apparent in many SIDS and landlocked developing countries, which are heavily challenged by their unique geographical, economic and logistical profiles. Additional constraints facing these countries result from their geographical disadvantage, small size, limited trade volumes, limited transport options and, often, trade flow imbalances that raise transport costs and further increase the vulnerability of the transport sector to external shocks.

Currently, freight transport, i.e. the transport of goods, accounts for 27 per cent of all transport energy use and is responsible for about 7 per cent of the global economy-wide greenhouse gas emissions, driven in particular by growing global trade and transport activity. At the same time, trade-related international freight volumes are expected to grow by a factor of 4.3 by 2050 compared to 2010. One third of trade in 2050 will

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occur among developing economies, compared to 15 per cent in 2010. World road and rail freight volumes are expected to increase more than three-fold and over five-fold, respectively, by 2050.

These trends underscore the challenges facing the transport sector and heighten its vulnerability to unsustainable patterns. Addressing these issues requires mainstreaming sustainability considerations into relevant planning and policy-making decisions. Mitigating the vulnerabilities weighing on transport and logistics requires, among other things, measures and actions that promote economically efficient, competitive, affordable and socially inclusive (multi-modal) transport systems, while at the same time achieving greater energy efficiency and environmentally friendly objectives.

Designing and implementing sustainable transport and logistics systems, especially in developing regions is crucial to tackling the varied vulnerabilities facing the transport sector. Multi-pronged approaches are required to help developing countries build capacity to ensure that their transport and logistics are better prepared to respond to multi-faceted vulnerabilities. Areas of intervention include improving understanding of risks, exposure and implications for the transport and logistics of developing countries.

The benefits of trade reforms to developing countries are substantial. Efficient and simplified trade procedures not only reduce cost and time to trade, they also lower the barriers of inclusion of small and medium-sized enterprises in global value chains and improve government revenues. Trade facilitation reforms could also help prepare countries for the growing digital economy and e-commerce, which are expected to dominate the global trading system in the coming years.

At a time when trade facilitation reforms have now become an obligation for the 164 members of the World Trade Organization under the Agreement on Trade Facilitation, developing countries, including LDCs, will need to pay even more attention to trade facilitation gaps in their national trade reforms, including SIDS that are in particular need of reforms of trade facilitation and port management systems and landlocked developing countries that are particularly vulnerable in border cooperation and transit.

In order to do so, trade facilitation reforms need to be implemented and applied correctly. It is important that countries implement their obligations according to their individual commitments. Even though there are visible signs of progress in trade facilitation across developing countries, including LDCs, challenges remain. Emerging threats and vulnerabilities in the multilateral trading system present both challenges and opportunities to developing countries, including LDCs.

Rising protectionism as well as heightened trade tensions in major economies put developing countries, including LDCs, in an increasingly uncertain position. As most of these countries are increasing trade in intermediate goods, tariffs could heighten prices and render products from developing countries uncompetitive. On the other hand, these emerging threats could present unique opportunities for developing countries to increase market share through favourable trading environments, improved trade procedures and other relevant trade facilitation reforms.

Implemented appropriately, trade facilitation reforms could ensure that developing countries, including LDCs, facilitate imports and exports, generate revenue for investments, eliminate poverty and trade into prosperity. Thus, advancing trade is a precondition for realizing the development agenda and must be included in national development agendas, said UNCTAD.