UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT
UNCTAD

No.86
JUNE 2021

POLICY BRIEF

Placing productive capacities at the heart of least developed countries' development policy and strategy: A call for change ahead of UNCTAD XV, UNLDC V and beyond*

The coronavirus disease (COVID-19) pandemic has brought to light not only the systemic interdependence of countries, but also the socioeconomic fragility of the global economy. From a trade and development perspective, this has been felt most acutely in the most vulnerable developing countries – the least developed countries (LDCs). Even prior to the onslaught of the COVID-19 pandemic, LDCs faced complex development challenges, compounded with economic growth patterns that have failed to translate into accelerated poverty reduction and job creation. As the international community prepares for the upcoming fifteenth session of the United Nations Conference on Trade and Development (UNCTAD XV) and the Fifth United Nations Conference on the Least Developed Countries (UNLDC V), innovative strategies and approaches to enhance economic growth and address underlying vulnerabilities are urgently needed. This policy brief is a call to action for LDC Governments and the broader international community of development partners to take concerted action in the fostering of productive capacities for sustainable development.

The weaker a country's productive capacities, the more vulnerable it is to external shocks, and the longer it will take to recover previous levels of growth. Understanding a country's productive capacities is key to identifying sources of systemic vulnerability, remedying them and turning these challenges into opportunities for sustainable and inclusive growth. A focus on productive capacities provides a better understanding of economic growth because their expansion, development, and utilization lie at the very heart of what drives growth and structural economic transformation. To support countries in assessing their productive capacities, and understanding their underlying dynamics, UNCTAD has launched a new tool – the Productive Capacities Index – to help countries identify gaps, improve their development policies and, ultimately, reduce poverty and build economic resilience.

Key points

- The least developed countries (LDCs) and development partners should prioritize the building, maintenance and use of productive capacities as an overarching framework of support for these countries.
- The forthcoming programme of action in support of LDCs and domestic policies in LDCs themselves should make productive capacities central in order to build resilience to shocks.
- Countries that have developed a broader and deeper set of productive capacities across various dimensions have been better positioned to face the effects of recent external shocks.
- Building and utilizing productive capacities is the key to achieving sustainable and inclusive economic growth in LDCs. That is, such growth and poverty reduction in the LDCs rely on fostering productive capacities.
- By developing productive capacities, LDCs will be better positioned to enter and compete in new international markets in goods and services, especially in more sophisticated value added goods, which leverage technology and innovation to go beyond primary commodities.

* For more information, see UNCTAD Productive Capacities Index and related publications and resources.

As developing countries and the broader international community intensify preparations for UNLDC V, the building, maintenance and full use of existing productive capacities should form an essential part of trade and development strategies to support not only recovery from COVID-19 and other shocks, but also long-term, inclusive growth.

A country's productive capacities are made up of interrelated core elements which together enable inclusive and sustained growth, and development. Each of these elements can be created or strengthened through a targeted set of policies and strategies. As development processes and the components of productive capacities are, by nature, interconnected and mutually reinforcing, the building, maintenance and use of productive capacities reflects a truly holistic approach to economic development.

UNCTAD defines productive capacities as the "productive resources, entrepreneurial capabilities and production linkages that together determine a country's ability to produce goods and services that will help it grow and develop".[1] As such, productive capacities encompass the diverse competencies, resources, skills, infrastructure, technological capabilities, institutions and knowledge systems that a country needs to produce and deliver progressively more sophisticated goods and services in an efficient and competitive manner.

What are productive capacities?

Core element of productive capacities	Development process
Productive resources • Natural and human resources • Financial and physical capital	**Capital accumulation – investment** • Maintenance and increase of stocks of natural, human and physical capital

Entrepreneurial capabilities
• Core competencies
  ◦ Application of current skills to existing productive resources
• Technological competencies
  ◦ Dynamic abilities to advance core competencies
	Technological progress – innovation
	• Development of new goods and services
	• Improvement of methods, equipment, skills and production organization

Production linkages
• Information exchange
• Resource flows
• Backwards and forwards linkages along the whole value chain
	Structural change – a virtuous cycle
	• Positive feedback loop between investment and innovation
	• Diversification of the economy through
	  ◦ Change in sectoral composition of output, production and employment
	  ◦ Pattern of linkages between sectors and firms

[1] UNCTAD, 2006, *The Least Developed Countries Report 2006: Developing Productive Capacities* (United Nations publication, Sales No. E.06.II.D, New York and Geneva).

Why focus on productive capacities?

Building and utilizing productive capacities is the key to achieving sustainable and inclusive economic growth in LDCs. It is by developing their productive capacities that LDCs will be able to mobilize domestic resources and finance their own economic growth. This has positive knock-on effects for development, including reducing their dependency on official development assistance and enhancing the ability to attract private investment and capital inflows. Furthermore, by developing productive capacities, LDCs will be better positioned to enter and compete in new international markets in goods and services, especially in more sophisticated value added goods, which leverage technology and innovation to go beyond primary commodities. From a socioeconomic perspective, developing productive capacities is also the key to addressing poverty and inequality in LDCs.[2]

Focusing on development of productive capacities helps countries avoid the trap of concentrating on only a few ingredients of production – such as machinery and equipment, physical infrastructure, human resource development or technological capabilities – as "magic bullets" for economic growth and poverty reduction. Understanding productive capacities provides a broad view of what is needed to produce goods and services in an economy. Context specific vulnerabilities can be identified, and through this more complete understanding of economic activity, better development policy can be formulated.

Additionally, focusing on productive capacities can generate outcomes that have an impact on a wide range of development related challenges, mainly poverty reduction. Understanding the structure of a country's productive capacities can enable the participation of unemployed and underemployed people in the labour market, including in economic activities of higher added value and with higher levels of productivity. It can also lower the price of wage goods, including food, and reduce price instability. Finally, as the productive base of an economy is strengthened, government revenue can increase and contribute to the delivery of improved public services and governance.

The Productive Capacities Index was developed in response to Economic and Social Council resolution 2017/29, which encouraged UNCTAD "to pursue its methodological work to measure progress in and identify obstacles to the development of productive capacities in developing countries". The methodological work and related research have resulted in the development of the Index as a practical tool to enable member States to monitor and benchmark their progress and achievements in building new and enhancing existing productive capacities over time, and their potential to achieve the Sustainable Development Goals.

The Productive Capacities Index

The Productive Capacities Index is the first comprehensive attempt to measure productive capacities in all economies and construct a multidimensional index that can provide country-specific insights and diagnostics of productive capacity development. The Index is an attempt to capture the broad concept of productive capacities and make the concept operational for policymakers.

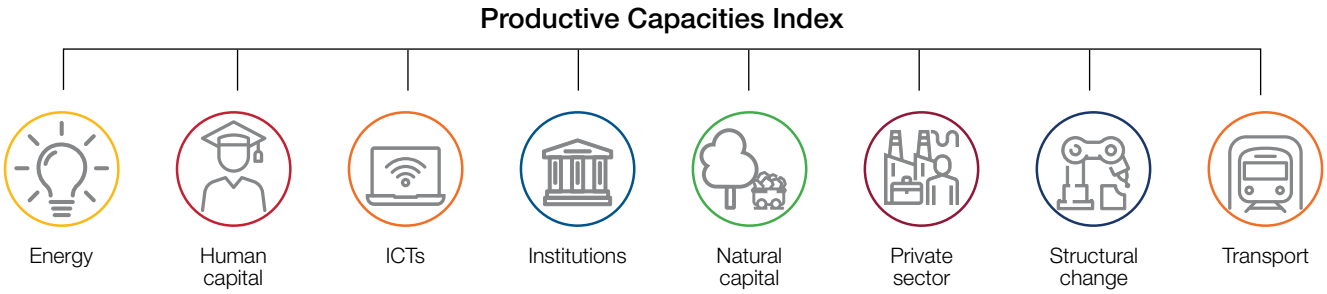
The Productive Capacities Index is calculated as a geometric average of eight domains or categories, namely, information and communications technologies (ICTs), structural change, natural capital, human capital, energy, transport, the private sector and institutions (see figure 1). The categories are selected on the basis of their relevance to the conceptual and analytical frameworks for building productive capacities. Productive capacities are measured across 46 indicators. The Index summarizes productive capacities by computing scores ranging from 0 to 100 using a variety of internationally comparable and rigorous data sources.[3] It includes data for 193 economies for the period from 2000 to 2018.

---

[2] UNCTAD, 2020a, *The Least Developed Countries Report 2020: Productive Capacities for the New Decade* (United Nations publication, Sales No. E.21.II.D.2, Geneva).

[3] Data sources include the UNCTADstat database, World Bank, World Health Organization, United Nations Educational, Scientific and Cultural Organization, Organisation for Economic Co-operation and Development, International Telecommunication Union, International Civil Aviation Organization and United Nations Environment Programme. The Index was calculated following internationally recognized statistical and econometric methodologies for developing a composite index. For data sources and the approach used, see https://unctadstat.unctad.org/EN/Pci.html.

Figure 1
Productive Capacities Index: Categories



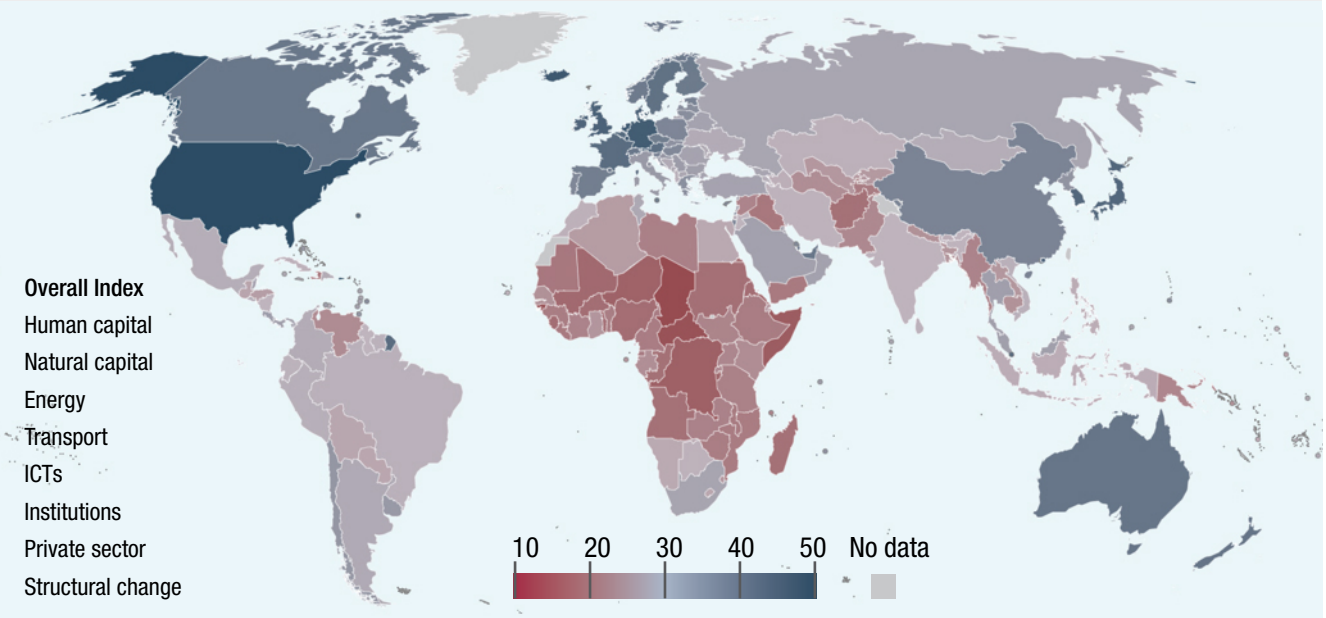
Using the Index

The multidimensional nature of the Productive Capacities Index provides a coherent and readable measure of a country's social and economic performance. Overall Index scores can provide a birds-eye view of how a country is performing in a format that can be used to benchmark and monitor development progress. The Index can also be used to identify economy-wide gaps and limitations at the national level to recalibrate and catalyse mutually supportive actions by Governments in weaker economies, aligned with action by other stakeholders and development partners.

The Productive Capacities Index allows policymakers to:

- **Assess** how far productive capacities have been developed in a country.
- **Benchmark** country performance over time or across countries.
- **Monitor** the effectiveness of past policies.
- **Improve** future policy choices.

Figure 2
Overall Productive Capacities Index, 2018*



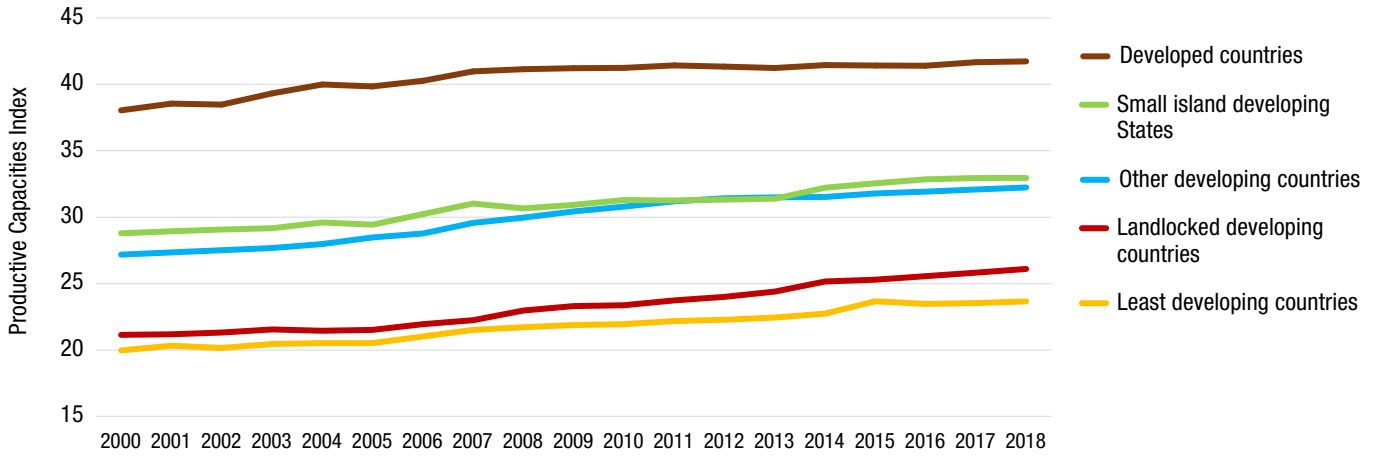
The boundaries and names shown and the designations used on this map do not imply official endorsement or acceptance by the United Nations.

* This map uses data from 2018, available on the main portal of the Productive Capacities Index at https://unctadstat.unctad.org/EN/Pci.html.

A visualization of the Productive Capacities Index scores in a world map (figure 2) shows that the highest scores for the Index are found in the developed world, while the lowest scores are found in poorer and structurally weaker developing economies.[4]

[4] The online version of the map is interactive, and it is possible to select specific economies to highlight and assess their progress in various categories over time.

Figure 3
Productive Capacities Index: Comparison of country groups



Source: UNCTAD (2021). *UNCTAD Productive Capacities Index: Methodological Approach and Results* (United Nations publication. Geneva).

In addition to this dimension, the Index can also provide a more granular understanding of development, within a country or among countries in a particular region, or in a given state of development. The Index allows for statistically rigorous comparison which can shed light on what has been working for development in similar contexts. Figure 3 highlights a comparison between country groups.

A comparison of Productive Capacities Index scores among country groups (figure 3) shows that landlocked developing countries and LDCs perform in a similar way.[5] Despite challenges, some improvement is visible and captured by the Index.

The gaps between country groups observed on the graph above correspond to gaps in levels of development. The Productive Capacities Index is correlated with other measures of development, such as GDP ($p = 0.91$) and the Human Development Index ($p = 0.92$). These positive and statistically significant correlations show that the Productive Capacities Index can help policymakers understand progress toward development outcomes.

Policy implications

A common struggle in many LDCs is the fragmented implementation of policy. Many interventions are project-based and, by nature, short-lived. This lack of continuity undermines the impact of even the most well-intentioned plans. Additionally, a lack of coordination leads to a crowded and confusing development landscape, which is not conducive to the holistic changes that are needed to achieve prosperity for all. As the Productive Capacities Index can provide both an overall and a detailed view of development progress, the Index can promote a cohesive approach to policy implementation and reveal opportunities for different actors to work together.

The Productive Capacities Index is a tool that can illuminate country specific obstacles and productive possibilities that domestic policymakers can use to build a tailored development strategy. While some wider development trends are revealed by the Index, as discussed below, each country is embedded in its own unique, national context and will require a customized mix of approaches and policies.

One policy area that the Index highlights in many countries is addressing weaknesses or handicaps in infrastructure – specifically electrification. Access to dependable and affordable electricity is necessary for technological progress and structural change towards higher value added economic

[5] UNCTAD, 2020b, *UNCTAD Productive Capacities Index: Focus on Landlocked Developing Countries* (United Nations publication, Geneva).

activities. Shortfalls in this area can be a binding constraint on the development process. Indeed, the Index indicates that the uneven distribution of energy services constrains the use of energy for productive purposes in many poor and structurally weak economies. This constraint undermines the capacity of firms to competitively produce and export. If viewed strategically, infrastructure investment can favour the expansion and upgrading of firms and farms.

Additionally, the Productive Capacities Index shows that scores under the ICT category are rising across all countries, but at different magnitudes and rates. A closer look at the indicators of the ICT category reveals that in many developing economies, ICT score increases are largely due to increases in mobile phone subscriptions. Access to broadband and the use of ICT in business and production remain flat over time, indicating structural shortfalls and limitations that targeted policy and investment could address.

LDCs are characterized by high Productive Capacities Index scores in the natural capital category, with comparatively lower performance across the other components of the Index. This reflects the focus of many of these economies on the export of primary commodities. The Index also reveals an inverse relationship between human and natural capital. Economies with higher scores on the natural capital category tend to perform lower in human capital, indicating a vast untapped potential of human capital development in economies focused on commodity exports. Economic diversification in commodity dependent LDCs is a long-standing development goal. Natural resource-driven economies have opportunities to invest in fostering productive capacities if rents from such resources are captured in productive transformation, including in the development of infrastructure, and channelled towards human capital formation.

Finally, the nexus between institutions and human capital is seen clearly in the results of the Productive Capacities Index. The provision of education and health care are fundamental to the development of human capital, and well-functioning public institutions are essential for adequate governance and necessary capabilities in policy formulation and implementation. All the interrelated processes of productive capacities development are mediated through institutions, and so performance in this category is essential for creating development policy that is both effective and sustainable.

It is impossible to ignore the interconnected nature of all categories measured by the Productive Capacities Index: macroprocesses and structural dynamics, as well as entrepreneurial activity at the micro-level influence the development of productive capacities. To create a virtuous cycle, the development of both productive capacities and domestic aggregate demand should be mutually reinforced within the context of an enabling macro framework. A paradigm shift in policy formulation and implementation in structurally weaker and vulnerable economies is urgently needed, as a “business-as-usual approach” is no longer an option.

It is in this context that that LDCs and development partners should prioritize the building, maintenance and use of productive capacities as an overarching framework of support for these countries. In this regard, the next outcome document of UNCTAD XV and the programme of action for LDCs to be adopted at UNLDC V should be organized around a productive capacities-centred approach for achieving sustainable development and inclusive growth. This includes dynamic and proactive intervention by Governments and international development partners that aligns with and complements domestic policies to achieve national development goals.

Contact

Mr. Paul Akiwumi
Director

Division for Africa, LDCs and Special Programmes

41 22 917 4066

ALDC@unctad.org

Press Office
41 22 917 5828
unctadpress@unctad.org
www.unctad.org

UNITED NATIONS
UNCTAD

UNCTAD/PRESS/PB/2021/4 (No. 86)