**ECOSOC:** Economic and Social Council

**Student Officer:** Ayşe Naz Bayraktar

**Issue:** Diversifying macroeconomic policies outside resource-based sectors

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# I. Introduction

Economic segmentation is the practice of transitioning a country's economy from a reliance on a single revenue stream to a variety of sources coming from an expanding number of industries and markets. It has historically been used as a tactic to promote beneficial economic growth and development.

For the majority of developing nations, economic diversification is still difficult. This problem is perhaps greatest for those with the lowest incomes, tiny, landlocked economies, and/or economies that are heavily dependent on a single commodity. Economic diversification for these nations is indissolubly connected to the structural transformation of their economies and the attainment of greater levels of productivity brought about by the movement of economic resources both within and across economic sectors.

For investors, portfolio diversity is crucial to attaining their financial objectives while minimizing risk. An asset-class-diversified portfolio does not, however, ensure diversified risk exposures. Markets for financial instruments are impacted by macroeconomic variables like inflation and GDP growth. Therefore, it would be useful for investors and portfolio managers to do study on how to diversify and limit a portfolio's risk exposures to macroeconomic issues.

Geographic diversification entails holding stocks from several locations. For the same reason that you don't want all of your money in a single nation or area, you don't want it all in a single stock. That stock's collapse would be devastating to your wealth.

The word also refers to multinational corporations' habit of locating operations in several locations or nations to lessen commercial and operational risks.

Geographic diversification, like diversification in general, is predicated on the assumption that financial markets in different regions of the world may not be significantly associated with one another. For example, if the stock markets in the United States and Europe are falling because their economies are in recession, an investor may transfer a portion of his or her portfolio to developing economies with greater growth rates, such as China and India.

The majority of large international firms are also geographically diverse. This allows firms to save costs by putting factories in low-cost areas and reduces the impact of currency fluctuation on their financial

statements. Furthermore, global diversification may benefit a corporation's profits by offsetting the effects of lower-growth locations.

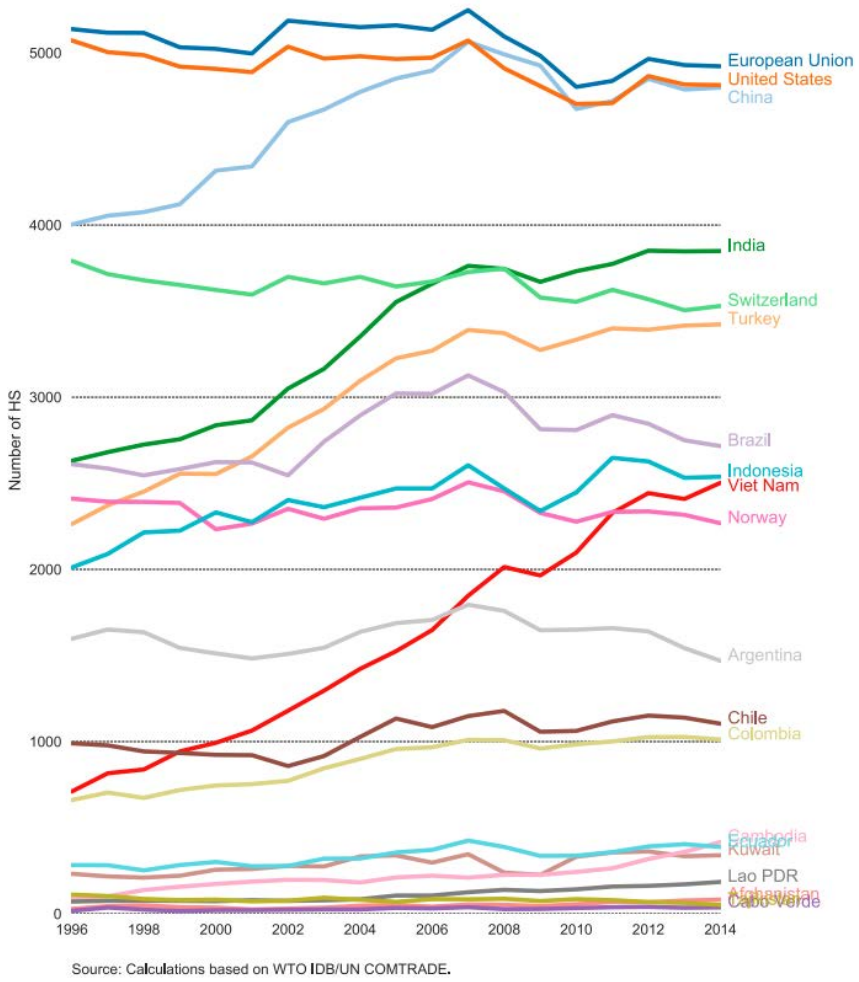


Figure 1: Product diversification of selected countries over time

# II. Involved Countries and Organizations

## EU (European Union)

Economic systems differ between eurozone nations, resulting in disparities in economic performance. The relative relevance of various economic activities for aggregate production is one example of diversity in economic systems. Many locally produced products and services are transferred across member nations and between the eurozone and the rest of the globe, which is one of the key causes for drastically varying value added structures among countries. Increasing international specialisation and trade integration are variables that contribute to shifts in activity relevance throughout time. All eurozone nations

rely heavily on trade in products and services. However, due to their specialization and geographical position, some member nations are more reliant on commerce than others.

Looking at the dispersion of growth performance in the eurozone 12, excluding countries that joined the eurozone after 2001 (Slovenia, Cyprus, Malta, Slovakia, Estonia, and Latvia), it can be seen that growth dispersion has been lower since the introduction of the euro compared to the previous corresponding period of the same length.

Divergences in GDP, inflation, and unit labor cost trends between eurozone nations have been generally mild since the monetary union's inception. However, certain member countries have consistently demonstrated poorer GDP growth and/or higher inflation and unit labor costs growth than others. The consequent competitiveness losses in these nations relative to their counterparts have also been reflected in heightened current account deficits following the introduction of monetary union, which are currently being rectified. In order to avoid severe imbalances in the future, inefficiencies in economic structures and rigidities in structural changes must be discovered and rectified early on by national policies.

## ESCAP (Economic and Social Commission for Asia and the Pacific)

The most inclusive intergovernmental forum in the Asia-Pacific area is the Economic and Social Commission for Asia and the Pacific (ESCAP). The Commission encourages collaboration among its 53 member States and 9 associate members in an effort to find answers to the problems facing sustainable development. One of the United Nations' five regional commissions is ESCAP.

By producing knowledge that can be put to use, as well as by offering technical assistance and capacity-building services in support of national development goals, regional agreements, and the implementation of the 2030 Agenda for Sustainable Development, the ESCAP secretariat promotes inclusive, resilient, and sustainable development in the region. ESCAP aids partners at the national level as well. The national offer of ESCAP is based on and related to the execution of international and regional frameworks and agreements.

ESCAP examines economic conditions and advocates for the implementation of macroeconomic and structural policies that promote economic development and productive employment while ensuring macroeconomic stability. It promotes the quality of economic growth and emphasizes the importance of considering the distributional repercussions of development initiatives.

ESCAP recognizes the critical role of development financing in implementing the 2030 Agenda for Sustainable Development. Priorities identified in this area include: strengthening domestic resource mobilization, including through tax cooperation and public expenditure management; improving quality

infrastructure investment while taking all aspects of economic, social, and environmental sustainability into account; and increasing the effectiveness of financial markets in supporting sustainable development.

ESCAP advocates for regional cooperation and integration as a means of closing development disparities among member countries. ESCAP conducts research and publishes regular publications such as the Economic and Social Survey of Asia and the Pacific and the ESCAP Financing for Development Series to provide evidence-based policy analysis. It also helps its member countries improve capability and conducts policy conversations.

## Sudan

According to the World Bank's Country Economic Memorandum (CEM), Sudan's economy falls behind many other countries in implementing structural change through highly productive sectors including manufacturing and non-traditional services.

Written according to an analysis of historical data, the report named "Realizing the Potential for Diversified Development" states that Sudan's economy had three different phases of variable economic growth between 1988 and 2013. Sudan's gross domestic product (GDP) increased by 4.9 percentage points on average between 1989 and 1997, primarily as a result of rising labor and total factor productivity (TFP). Due to the emergence of oil revenue between 1998 and 2007, GDP growth accelerated and economic activity rose by 6.1 percentage points; in the "oil economy," physical capital replaced labor as the main engine of the nation's economy. But in 2008, as negative TFP growth started to set in, the oil economy began to collapse. This was made worse by South Sudan's secession in 2011, which left Sudan's economy severely damaged and caused the loss of most of its oil reserves and associated fiscal revenues.

Proven by the major shares of the country’s top exports, the export markets of Sudan seem to be highly concentrated. However, there is hope regarding the relatively low degree of concentration for non-oil products, as it seems to signal that following the cessation of South Sudan, the country has already begun to diversify its non-oil exports. In addition, the report also promotes the endeavor to obtain economic diversification in order to boost growth by enlarging the nation's endowment base, which serves as the basis for pursuing effective economic opportunities, and boosting productivity, especially in agriculture. Economic diversification was critical during the "oil economy" years between 1999 and 2011, but it is now even more crucial as the nation looks for alternate ways to gain foreign exchange through exports.

## Nigeria

Because crude oil dominates the Nigerian economy in terms of export share and foreign exchange earnings, neglect of other economic sectors (such as agriculture, manufacturing, and services), a limited

base of the nation's exports and foreign exchange earnings, and political unrest and agitation in the oil exploration industry, the country's policymakers have been concerned about the unstable growth performance of the Nigerian economy. As a result, export diversification offers a reasonable solution for tackling the aforementioned problems and achieving sustained growth and even development throughout the nation. Diversification of exports, however, had a minimal impact on Nigeria's economic expansion. Oil has been the economy's main source of income and foreign exchange revenues. In contrast to the oil sector, the performance of other economic sectors has been negligible in terms of their percentage contribution to real GDP. Because of the country's continuous dependence on oil exports, efforts to diversify its economy have not produced any appreciable effects. This explains the minimal impact of export diversification on the economy.

### Iraq

In the World Bank's new Iraq Country Economic Memorandum named "Breaking out of Fragility", the author shows how Iraq's oil wealth helped the nation achieve upper income status for decades, despite the fact that the nation's institutions and social and economic outcomes mostly resembled those of a fragile low-income nation. Oil profits diminished the nation's ability to compete economically, lessened the need for taxation, undermined the connection between citizens' accountability and the state, and encouraged corruption.

The research emphasizes that improving openness in the administration and distribution of its oil wealth and public resources, as well as refocusing the country's political settlement on growth, should be Iraq's top priorities. The report also highlights how crucial it is for Iraq to improve citizen engagement and hold the government more accountable for delivering infrastructure and services that are of the utmost importance. It also suggests that Iraq should be more responsive to youth demand for jobs and it should make more efforts to tackle socioeconomic inequalities. In addition, In order to diversify the economy away from oil extraction and toward trade and integration, Iraq should explore its export possibilities. Iraq's geographic location may make it a hub for regional logistics, but the country performs so poorly in this area compared to its contemporaries that it acts as a bottleneck for the region.

## III. Focused Overview of the Issue

### Benefits of Economic Diversification

When demand levels result in higher prices, as they have over the previous ten years, producers are encouraged to increase output. The production base, with its constrained capacity, has few options to offer

as prices drop.

In the hopes of lessening the erratic nature of economic and export growth, the typical approach is to encourage economic diversity is also one of the reasons why it might be perceived as a policy priority for low and middle-income economies.

But what makes current studies at ESCAP and elsewhere so appealing goes beyond the usual circumstances that need diversity.

The more economically diversified a country is, the higher its GDP, the less competition it faces for its products on the world market, and the more pronounced is the tendency for its diversification to flourish along particular pathways, from the existing production base to new sectors, according to data on global trade.

Economic diversification not only lessens a country's exposure to the ups and downs of international commerce, but it is also significantly linked to increased production from a wider variety of commodities and services. Additionally, according to trade data, diversity is linked to a decrease in the average number of rivals for export goods in the international market, which benefits private companies' ability to raise their market share and earnings.

These correlations are supported by data showing that diversification occurs when new economic efforts extend a nation's production base along particular paths. When it moves in the proper direction, diversification appears to be a path-dependent process that results in self-reinforcing growth.

What a nation produces now affects what industries could quickly develop in the future. The effects on connected economic sectors might vary depending on what a new investment decides to generate. Some routes can result in the development of new goods, increased diversification, and increased productivity inside a nation.

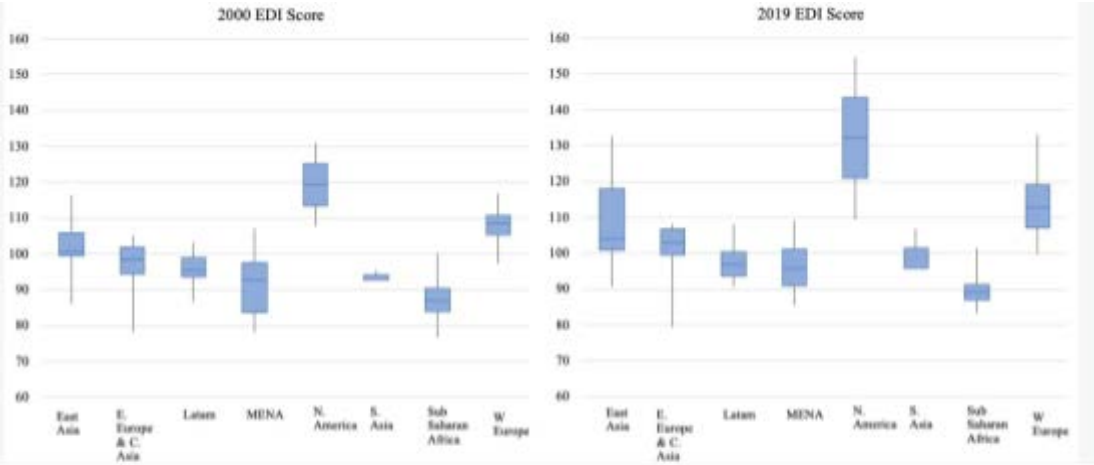


Figure 2: EDI Scores of Countries

Looking beyond commodities, the study finds that economy-wide policies such as governance and education stimulate varied exports more than narrowly targeted industrial policies, a conclusion that can benefit nations seeking to grow their international commerce.

The assessment of 201 nations and territories goes beyond the usual economic complexity metrics employed by economists. Those proxies for a specific economic system's production capabilities are very sensitive to commodities, which might skew their accuracy.

For a more nuanced read, staff research provides new techniques to assess the diversity and complexity of national exports, as well as how economic policies may encourage such diversity. Economists refer to these policies as horizontal since they apply extensively across a country rather than targeting specific industries.

It could be possible to support policymakers for growth in economic diversification by mapping the links across sectors and comprehending the distinctions that indicate success or failure. These "product space maps" have been created; in this book, ESCAP publishes one of its own, together with a discussion of the technical considerations in an appendix.

According to ESCAP research, diversification often occurs in small increments rather than abrupt changes. Sectors with necessary producing capacity near to existing output see new production opportunities. According to empirical research, the degree of "complexity" connected with any product may be used to determine if a product is potentially suitable for further diversification.

The degree of productive capacity used in a product's production determines how complicated it is. Through trade data that tracks a nation's export activities, ESCAP has indirectly assessed product complexity.

In general, economies with fewer and more diverse producers generate more complicated goods. Many nations with low levels of diversity generate less sophisticated goods. A common trait of many low-income nations is the limited export diversification and the larger economic structure. Concentration in industries like primary commodities that have little room for productivity growth and quality improvement might lead to less diversified and sustainable growth. Lack of diversity may also make you more vulnerable to bad outside shocks and macroeconomic instability.

## Disadvantages of Economic Diversification

Because we are taught that the aim of portfolio diversification is to reduce portfolio risk, we rarely consider the downsides of diversification in investing. In truth, some degree of diversity is required; otherwise, you will be incurring risks that will not be rewarded for.

Some lessons, however, can be learnt too many times. Diversification that is done incorrectly, particularly over-diversification, may be extremely detrimental.

There are only so many high-quality firms, and even fewer that are priced to give a margin of safety. The greater the number of companies in your portfolio, the less concentrated your portfolio will be on the greatest possibilities.

Many investors have so many assets in their portfolio that they don't know what's in them. Diversification is vital in investing, but keep your portfolio basic enough that you can keep track of it.

If your portfolio has too many assets, it effectively becomes an index fund. If you want an index fund, purchase an index fund; don't squander transaction costs by acquiring a slew of assets that eventually become an index fund.

## Growth Linked to Diversification in Low-Income Countries

Little is known about how diversification is linked to growth and macroeconomic stability in low-income countries (LICs). Most LICs have historically been heavily dependent for the bulk of their export earnings on a narrow range of traditional primary products and few export markets. A key concern is that such limited diversification, reflecting a broad range of market and government failures, may result in less broad-based and sustainable growth, with production and exports concentrated in sectors characterized by low technology spillovers and limited opportunities for productivity growth or quality upgrading. Economic diversification is a difficulty for most developing nations, particularly those with the lowest incomes and economies that are tiny, landlocked, and/or dominated by primary commodity reliance. Economic diversification is closely linked for such nations with structural change of their economies and attainment of better levels of productivity as a result of the movement of economic resources within and across economic sectors. Moreover, lack of diversification may increase exposure to adverse external shocks and vulnerability to macroeconomic instability. Although diversification is a longstanding ambition of many LICs, experience is limited with regard to which aspects of diversification are important, what drives it, and how to promote it without resorting to the risky and often counterproductive practice of “picking winners”which specifically means to support  certain investors and/or sectors.

Measures of economic diversification must go beyond trade in order to account for domestic sector diversification and the dynamic structural transformation process that underlies it. In theory, trade diversification and domestic diversification go hand in hand, with the former capturing diversification in the external sector and the latter capturing it in the domestic production process across sectors. This note's underlying thesis is that a more complete and informative image may be created by concentrating on the production process as a whole. As a result, the two aspects of diversification are assessed concurrently,

filling a gap in the prior research that had dealt with them separately. The research also concentrates on "diversification spurts," which are substantial, prolonged periods of rapid diversification.

Trade diversification is possible along a number of axes. The first type of diversification might involve either trading partners or products. Second, product diversification may take the form of new product lines (the vast margin) or a more evenly distributed mix of currently exported goods (intensive margin). Last but not least, improving product quality reflects a somewhat different idea and is demonstrated by increased pricing for current exports.

Greater trade diversity is often correlated with higher per capita income. This overarching relationship is valid at least up until a country's economy becomes an advanced economy. Figure 1, which shows country-year observations, clearly illustrates this link, with a lower Theil index value denoting greater variety. It also applies when the figure is limited to display just cross-sectional or time-series variation; in the latter scenario, the extended time dimension of the dataset is crucial for establishing the existence of the correlation.

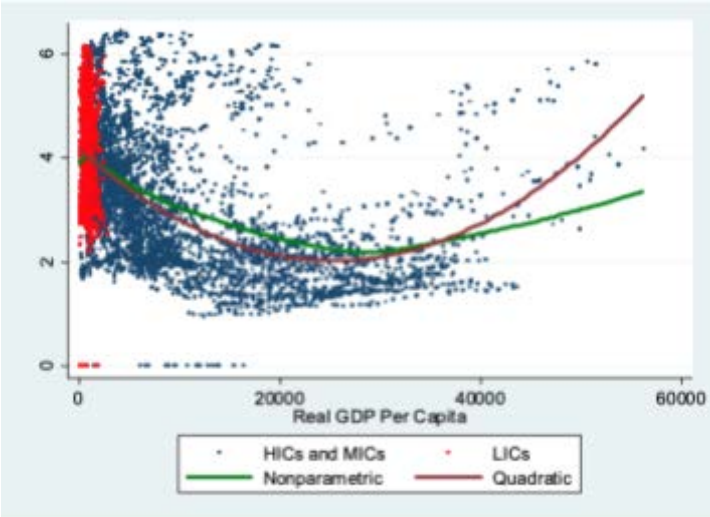


Image 1: Diversification and Real GDP Per Capita

The state of the world economy is stagnant, and a growing sense of unease surrounds its future. These developments have a significant impact on nations whose economies rely substantially on the manufacture and export of a narrow range of goods or on sales to a restricted number of foreign markets. Prices of the minerals and other essential commodities, which make up a large portion of the exports of many developing nations, have also fallen dramatically. All of this emphasizes the need for diversification methods that may provide inclusive, job-intensive development that is sustained.

A rising number of client nations aiming to achieve more economic diversification are collaborating with the Trade & Competitiveness Global Practice (T&C), a joint initiative of the World Bank and International Finance Corporation (IFC), of the World Bank Group. Regardless of economic conditions, this is a worthwhile objective, but it is now more so than ever since pressures on emerging nations with sector-dependent economies are intensifying.

The idea of the resource curse, also known as the resource trap or the paradox of plenty, refers to a paradoxical situation in which a country with an abundance of rich natural resources underperforms economically. When countries fail to invest adequately in non-resource industries, notably manufacturing,

they become exposed to reductions in natural resource prices and therefore to long-run economic underperformance. The resource curse and blessing, or the antagonistic and complimentary connection between natural resource abundance and economic growth, have received much attention. According to studies, if the currency has a floating exchange rate, it creates a significant nominal and real appreciation in the currency, and it limits exports in non-resource sectors due to short-term high and comparatively easy profits in the resource sectors.

## IV. Key Vocabulary

Macroeconomic factors: A macroeconomic factor is a significant fiscal, natural, or geopolitical event that has a significant impact on the economy of an area or a country. Instead of affecting only a small number of chosen individuals, macroeconomic influences typically affect large swathes of populations. Macroeconomic influences include, for instance, inflation, unemployment rates, and economic outputs. Governments, corporations, and customers all closely watch these economic success metrics.

Macroeconomic factor cycle: Macroeconomically speaking, economies frequently go through cycles. Positive factors encourage prosperity, but rising prices may result from greater demand, which might then cause people to become more frugal with their spending. Prices might decline once more when supply starts to surpass demand, resulting in more prosperity up until the next change in the supply and demand of goods and services.

Low-Income Countries (LICs):LICs are nations with a low degree of economic development.

High-Income Countries (HICs): HICs are nations with a high level of economic development.

Middle-Income Countries (MICs): Middle-income countries are those that fall between LICs and HICs in terms of income level. A large number of these nations are also NICs (Newly industrialized countries).

Newly industrialized countries (NICs): An area that has developed industry is referred to as being industrialized. This comprises manufacturing companies, tech businesses, and other sectors that support the local economy. Newly Industrialized Country, often known as NIC, is another phrase associated with industrialisation. This phrase was used by economists and political scientists to refer to nations whose economic growth lies between the First World and developing categories. Workers move from rural to urbanized areas, and NIC nations have economic expansion that is driven mostly by exports.

There are just a few countries that are now considered NICs. Brazil, China, India, Indonesia, Malaysia, Mexico, the Philippines, South Africa, Thailand, and Turkey are among these countries. These are NICs, according to the majority of economists and political scientists.

One popular method of determining a nation's degree of development is by measuring its gross national income (GNI) per capita. The GNI measures a nation's average level of wealth among its people. GNI makes it possible to compare various nations.

## V. Important Events & Chronology

| Date (Day/Month/Year) | Event |
|---|---|
| 1950s | The Korean War highlighted Japan's transition from economic slump to recovery. The Japanese economy was growing and changing when it regained independence in 1952. Sustained affluence and strong yearly growth rates, which averaged 10% in 1955-60 and eventually reached more than 13%, transformed many aspects of Japanese life. Farmers in the countryside who had profited from land reform began to experience the consequences of small-scale automation and a constant migration to industrial centers. Agricultural yields increased as new crop strains and modern technology were introduced, as home appliances became available in rural areas, and as shifting patterns of urban food consumption gave a larger market for cash crops, fruits and vegetables, and animal products. |
| 1980-2020s | Mexico's GDP growth from 1980 to 2020, the Mexican economy has faced several hurdles throughout the years. The GDP dropped dramatically in 2009. This coincided with the 2008-09 financial crisis, which affected practically all global economies. |

| | |
|---|---|
| 2000-08 | Slovakia expanded by over 6% per year in per capita terms between 2000 and 2008. As a result, Slovakia has significantly closed the economic gap between itself and more developed Western European countries: Slovakia's GDP per capita climbed from 43% to 64% of the EU-15 average between 2000 to 2008. However, the crisis slowed the process severely; Slovakia's average GDP per capita growth since 2008 has been only slightly above 1%. |
| 2020-Present | Centuries of developing numerous sectors and trademarks, as well as a stable government giving several economic packages to assist businesses throughout the epidemic, aided Switzerland's recovery. This was especially crucial for small and medium-sized businesses, which account for 99 percent of all businesses in the country and employ around 63 percent of the workforce. Switzerland supports new businesses even more by offering several chances for government financing and low taxation rates, making it an ideal location for tech entrepreneurs looking to establish a footprint in Europe. |

## VI. Past Resolutions and Treaties

There are no specific past resolutions or treaties regarding this issue, however organizations such as the IMF, ESCAP and WorldBank have published numerous reports on diversifying exports. For instance:

- Economic Diversification in Asian Landlocked Developing Countries: Prospects and Challenges

The Second United Nations Conference on Landlocked Developing Countries' discussions benefited from the ESCAP's publication. It includes information that has been gathered, fresh viewpoints and methods, as well as policy recommendations for Asian Landlocked Countries (LLDC) to alter their economic systems. The report's assessment of prospective new markets, products, and industries for each of the twelve Asian LLDCs is a crucial and practical contribution.

- Economic Diversification in LICs: Stylized Facts and Macroeconomic Implications

By taking into account diversity in the broader domestic economy as well as trade, this essay clarifies the importance of diversification in the macroeconomic performance of LICs.

- UNFCCC, Economic diversification

The UNFCCC has gathered resources on Economic Diversification, sorting them based on different coveners, themes and different dates. The themes of these forums and documents vary from "Economic Diversification and adaptation" to "Impacts, vulnerability and resilience of economic diversification".

## VII. Failed Solution Attempts

Economic diversification continues to be a major problem for the majority of developing countries. Indeed, until per capita incomes exceed $9,000, diversity and growing per capita incomes go hand in hand; after that, growth seems to lead to more concentrated economies. Diversification is the biggest difficulty for low-income countries and countries whose economies are dominated by commodities or minerals. Economic diversification is intrinsically linked for these nations with structural change of their economies and attainment of better levels of productivity as a result of the movement of economic resources within and across economic sectors.

Small economies confront unique issues since diversification is constrained by size, as there is little possibility to efficiently create a large variety of items. This is sometimes exacerbated by insufficient connection as a result of having a landlocked or island economy.

Regional and global integration play an important role in these nations in overcoming limiting size and addressing connectivity, particularly through mobility of people to perform activities and services elsewhere. There are also particularly tight ties with macroperformance, as the best reaction to volatility is better managed fiscal, monetary, and exchange rate policies than measures to diversify the structure of production.

## VIII. Possible Solutions

The new method of explaining diversification emphasizes the necessity of efficiently reducing geographic distance by fostering greater connectedness between nations for governments aiming for more varied trade flows. By minimizing the amount of time that commodities must travel between ports, for example, better transportation logistics can effectively shorten distance. Other beneficial policies consist of lowering trade policy hurdles, improving trade facilitation, promoting the diffusion of technology through

educational exchange programs, and funding communication technologies such as broadband that assist the digital economy.

Countries could also make some significant policy adjustments in the areas of controlled markets, subsidies, and the promotion of fertilizer use in order to help countries improve the productivity of their agricultural sectors. They could also strengthen institutions for diversification and reconsider the place of natural resource exploration in the economy to improve the management of natural resource rents. Finally, Member States could build human capital to support modern services that require a high level of expertise and to lessen spatial inequities, notably through raising the overall standard of education to alleviate the labor shortage.

## IX. Useful Links

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  ECLAC Subregional Headquarters for the Caribbean, Focus magazine of the CDCC about Economic Diversification in the Caribbean

- www.investopedia.com/terms/m/macroeconomic-factor.asp#:%7E:text=What%20Is%20a%20Macroeconomic%20Factor,just%20a%20few%20select%20individuals.
  What is a Macroeconomic Factor?

- www.wto.org/english/res_e/booksp_e/aid4trade19_chap5_e.pdf
  ECONOMIC DIVERSIFICATION: LESSONS FROM PRACTICE Contributed by the World Bank Group

- https://www.cannor.gc.ca/eng/1388762115125/1388762170542
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