



# Economic Diversification and Sustainable Development: Linkages and Barriers

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# The key message

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- There are important linkages between ED and SD.
- However, there are also real and substantial barriers to and between them.
- The challenge is to strengthen the crucial linkages and take actions to lower the barriers



# Structure of presentation

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- Defining economic diversification (ED) and sustainable development (SD)
- The relevance of the SD perspective to ED
- Linkages between ED and SD
- Barriers to ED and SD



# Defining economic diversification

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- ED refers to the process whereby a growing range of economic outputs are produced
- It can also refer to the diversification of markets for exports or of income sources.
- ED is part of, but distinguished from, economic development, as the latter implies not only different of output, but also changes in the technical and institutional arrangements by which output is produced and distributed (Herrick and Kindleburger, 1983)



# Why is economic diversification important?

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- Decisions by various COPs of UNFCCC have committed the Annex I countries to assist those non-Annex I countries, whose economies are 'highly dependent on income generated from the production, processing and export, and/or on consumption of fossil fuels and associated energy-intensive products', to diversify their economies.
- Further consideration of the relative extent of the potential impact of the response measures suggests that the ED issue affects most significantly the least developed countries (LDCs) and oil-exporting countries (OECs), as there is a severe lack of ED in these economies.



# Why is economic diversification important?

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- This lack increases these economies' vulnerability to fluctuation in primary commodities (oil or else) markets, and reduces their adaptive capacity to climate change (CC).
- It also reduces these economies' long-term prospects given depleting natural resource stocks.
- However it is legitimate to ask whether whether the issues of adaptive capacity and long-term prospects can be effectively addressed by ED alone.
- Zhang (2003) argues that it can't be, and that it is necessary to broaden the discussion by bringing in the perspective of sustainable development (SD).



# Why is it necessary to integrate ED into sustainable development?

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- A quick answer is that SD is a much more pertinent perspective. Only SD has the capacity to fundamentally strengthen adaptive capacity and safeguard these economies' long-term prospects in the face of depleting natural resources and under the weight of the response measures.
- SD has many definitions, but with the same central message, i.e.. today's development should not be at the expense of the future.
- The most widely accepted definition is that SD is "the development that meets the needs of the present without compromising the ability of the future generations to meet their needs" (Brundtland Report).
- The same report also spells out the key requirements in order to attain SD



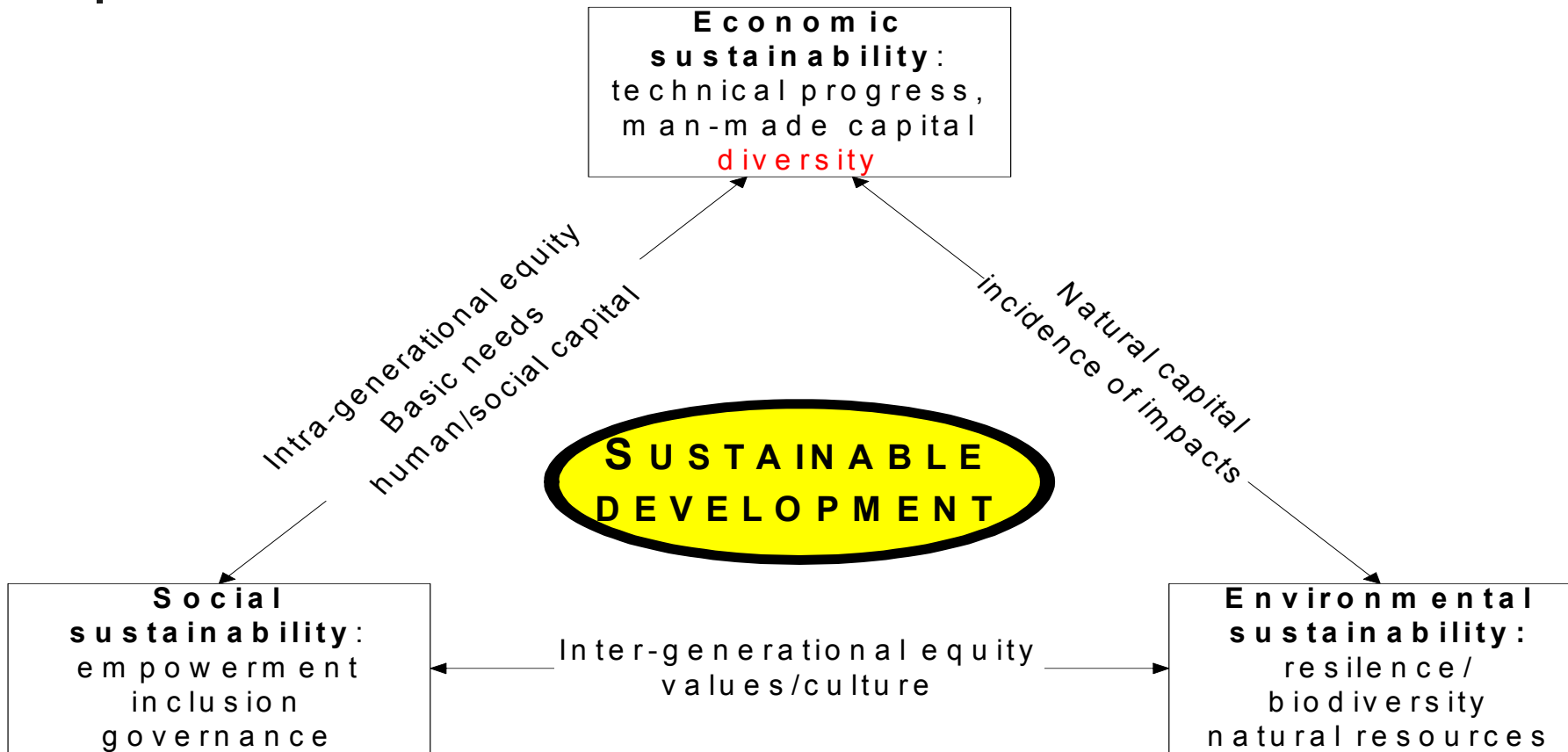
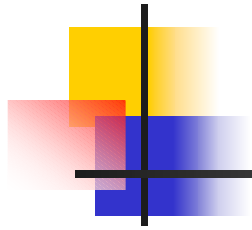
# SD's key requirements

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1. These are:
  1. Meeting the poor's basic needs (i.e. poverty reduction)
  2. Ensuring environmental sustainability
  3. Expanding the 'environment's ability to meet people's needs by improving technology and social organisation
  4. Equity both within and between generations
2. Their inter-dependence is illustrated by the sustainability triangle (see next slide)



# The sustainability triangle





# Insights from the sustainable development perspective

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- This sustainability triangle offers a great insight – economic sustainability (which encompasses economic diversity, as well as accumulation of man-made capital and technical progress) does not stand on its own; it draws upon and is strengthened by natural capital from the environment and social and human capitals from the society.
- This suggests that ED can be best achieved by addressing poverty and equity, and by improving technology and social organisation (i.e. the SD agenda).



# Insights from the sustainable development perspective

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- Moreover, the SD perspective has encouraged us to look at economic well-being holistically and in much longer-term through the notion of economic sustainability, which refers to the maximisation of present flow of income without diminishing the total stock of assets.
- This alerts us to the fact that some economies (e.g. OECs) are structurally vulnerable because of heavy reliance on natural capital – a substantial barrier.

# Wealth by Region, 1994

Region	US\$ 1,000 per capita				Percentage of total wealth		
	Total wealth	Human resources	Produced assets	Natural capital	Human resources	Produced assets	Natural capital
North America	326	249	62	16	76	19	5
Pacific OECD	302	205	90	8	68	30	2
Western Europe	237	177	55	6	74	24	2
<b>Middle East</b>	<b>150</b>	<b>65</b>	<b>27</b>	<b>58</b>	<b>43</b>	<b>18</b>	<b>39</b>
South America	95	70	16	9	74	17	9
North Africa	55	38	14	3	69	26	5
Central America	52	41	8	3	79	15	6
Caribbean	48	33	10	5	69	20	11
East Asia	47	36	7	4	77	15	8
East & Southern Africa	30	20	7	3	66	25	10
<b>West Africa</b>	<b>22</b>	<b>13</b>	<b>4</b>	<b>5</b>	<b>60</b>	<b>18</b>	<b>21</b>
South Asia	22	14	4	4	65	19	16

Source: Furtado *et al* (2000), table 4.1



# Barriers

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- Economic diversity is often the consequence of long-term economic growth and structural changes. There are relatively few successful cases among developing countries that have achieved economic diversification of their economies.
- Studies suggest that OECs suffer from particularly high structural and institutional barriers to economic diversification, mainly due to:
  - Extreme variability of export earning
  - The Dutch Disease
  - Large and expensive projects
  - Over-commitment in social responsibilities
  - Blunted incentive for entrepreneurship (Gelb *et al*, 1988)



# Conclusions

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- The SD perspective sheds useful light on the issue of ED.
- It shows that the objective of promoting economic diversification can be best achieved by pursuing SD
- SD in turn can be reliably obtained by building up three other types of capitals (i.e. man-made, social, human capitals), as well as slowing down the pace of depleting natural capital and minimising the impact of response measures.
- A lot needs to be done in developing human and social capitals in OECs and LDCs.