

# THE LEAST DEVELOPED COUNTRIES REPORT 2004

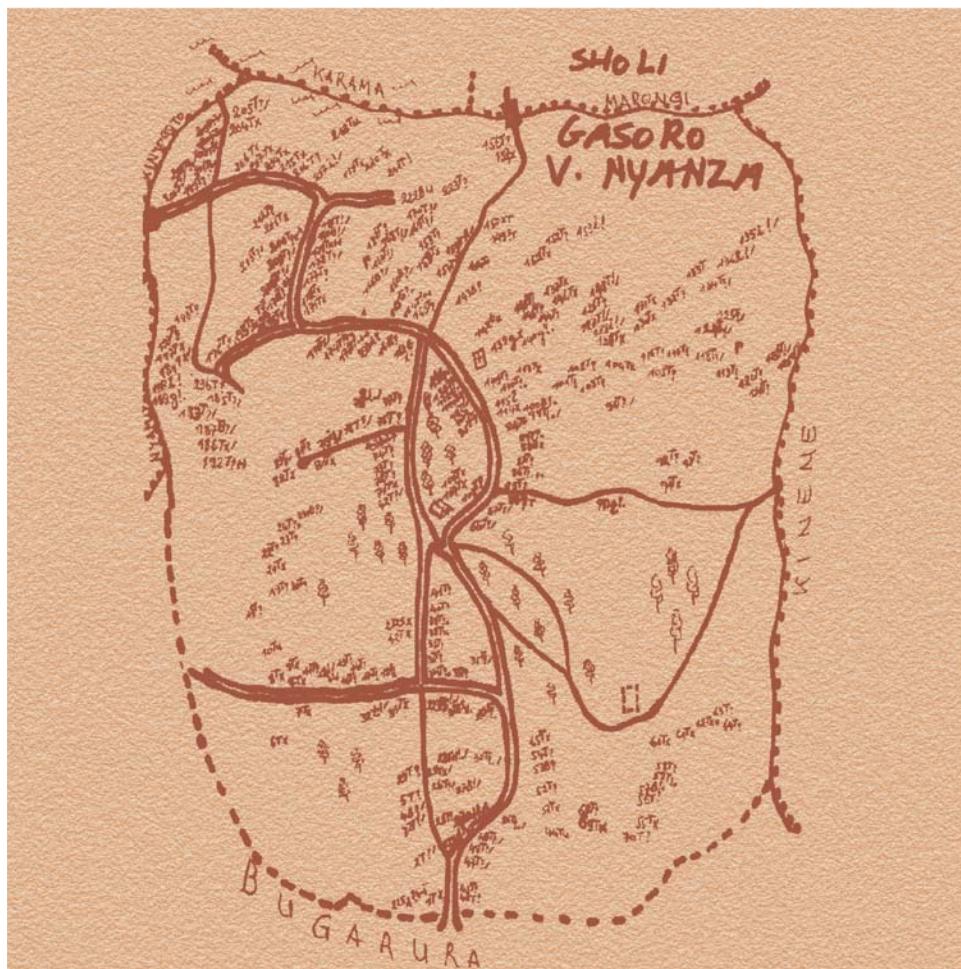
## OVERVIEW

by the Secretary-General of UNCTAD



UNITED NATIONS

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UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT  
Geneva

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UNITED NATIONS  
New York and Geneva, 2004

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UNCTAD/LDC/2004 (Overview)

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# Overview

## THE CHALLENGE OF POVERTY REDUCTION IN THE LEAST DEVELOPED COUNTRIES

International trade is vital for poverty reduction in all developing countries. But the links between trade expansion and poverty reduction are neither simple nor automatic. The purpose of this Report is to clarify the links and to contribute thereby to a better understanding of the national and international policies that can make international trade an effective mechanism for poverty reduction in the least developed countries (LDCs).

On the front cover of this Report, to put the problem in perspective, is a map of poverty. This map, reproduced from the Rwanda Poverty Reduction Strategy Paper, is the result of a participatory process in which a community — Sholi in Nyanza District, Rwanda — sought to identify its most important development problems. The map shows every household's location, its type of shelter, and also, most crucially, the community members' own assessment of their social category. There are 230 households and they were classified as follows:

- Umutindi/Umukene Nyakujya (43 households). They have to beg, for they have nothing — no clothes, no food, no shelter. Their children cannot go to school, they cannot afford medical care and they have no farmland.
- Umutindi/Umukene (114 households). They do not have sufficient food but can work for others to survive; they dress poorly, have insufficient farmland and can hardly get medical care. They have shelter but no livestock and are always suffering.
- Umutindi/Umukene wifashije (60 households). They have shelter, but it is small and poor. They have a minimal harvest; their children can go to primary school; they can clothe themselves but with difficulty; they can scarcely access medical care, but manage to have sufficient to eat and they have small ruminants.

- Umukunga (13 households). They have excess harvest to sell and livestock; they can afford medical care, and have a little money. Their children can go to secondary school. They eat well, are neat, have a good house and a bicycle, and can engage others as labour.

The situation in Sholi in Rwanda illustrates the nature of poverty in the LDCs. Poverty in these countries is not a phenomenon that affects a small proportion of the total population. Rather, it affects the majority. Moreover, this is a situation in which the majority of the population are living at or below income levels which are sufficient to meet their basic needs. In these societies, the available resources, even when equally distributed, are barely sufficient to cater for the basic needs of the population on a sustainable basis.

Conditions of life such as those in Sholi are an ethical affront to a civilized world. But they are not rare in the LDCs. Both World Bank and UNCTAD poverty estimates suggest that 49–50 per cent of the population in the LDCs were living on less than \$1/day at the end of the 1990s. Although the LDCs had a much better economic performance in the late 1990s, the overall incidence of extreme poverty for the group as a whole did not decline during that decade. If these trends persist, it may be estimated that the number of people living in extreme poverty in the LDCs will increase from 334 million people in 2000 to 471 million in 2015. By that time, and assuming that the current progress in China and India continues, the LDCs will be the major locus for global poverty in 2015.

Living conditions such as those in Sholi exist in other developing countries. But dealing with these conditions in the LDCs is especially challenging because extreme poverty is so pervasive throughout society. In this situation, mass poverty reinforces the tendency towards economic stagnation, and vice versa. Amongst the domestic vicious circles the following may be noted:

- There are few surplus financial resources available for investment and for funding vital public services, including education, health, administration, and law and order. Low income leads to low savings; low savings lead to low investment; low investment leads to low productivity and low incomes.

- To reduce risks in conditions of extreme scarcity, people pursue economic activities with low but certain returns, including production for their own subsistence and survival through multiple activities.
- The lack of effective domestic demand associated with all-pervasive poverty reduces profitable investment opportunities.
- There is a dearth of domestically available skilled personnel, and the lack of domestic opportunities encourages skilled people to seek work outside the country.
- Pervasive poverty leads to environmental degradation as people have to eat into the environmental capital stock simply to survive, but this in turn undermines the productivity of key assets on which livelihood depends.
- There is a high risk of civil conflict in countries where low per capita income is associated with economic stagnation or regress.

Three facts illustrate the situation most clearly. First, in the second half of the 1990s the average per capita income in the LDCs when measured in terms of current prices and official exchange rates was \$0.72 a day and the average per capita consumption was \$0.57 a day. This implies that on average there was only \$0.15 a day per person to spend on private capital formation, public investment in infrastructure and the running of vital public services, including health, education, administration, and law and order. Second, in 2001, 34 per cent of the population aged between 15 and 24 were illiterate in the LDCs. Third, 60 per cent of the LDCs experienced in the period 1990–2001 civil conflict of varying intensity and duration that, in most cases, erupted after a period of economic stagnation and regression. In Rwanda, for example, average private consumption per capita fell by over 12 per cent between 1980 and 1993, the year before the genocide occurred. Average private consumption per capita is somewhat higher now than it was in 1993.

The challenge of poverty reduction in the LDCs is how to reduce poverty given this starting point. The households in Sholi have a good idea of what to do. They see increasing their assets and the productivity of those assets to be the key element. The priority is quite simply to get goats that will provide all kinds of by-products, including manure to increase and maintain the productivity of their fields. But does this mean that international trade is irrelevant for poverty reduction? What has

international trade got to do with poverty reduction in such circumstances?

This Report is about the relationship between trade and poverty in the LDCs. The central questions that it seeks to answer are:

- What is the potential role of international trade in poverty reduction in the LDCs?
- How does the relationship between international trade and poverty work in practice in the LDCs?
- What are the national and international policies that can make international trade a more effective mechanism for poverty reduction in the LDCs?

## WHY INTERNATIONAL TRADE MATTERS FOR POVERTY REDUCTION IN THE LDCs

This Report argues that in conditions of mass poverty such as those found in the LDCs, poverty reduction requires sustained economic growth of a type that substantially increases average household incomes and consumption. Sustained poverty reduction cannot be achieved through welfare transfers, although these may be used, at any moment in time, to alleviate instances of the most extreme misery. Rather, it requires the efficient development and utilization of productive capacities in a way in which the working-age population becomes more and more fully and productively employed.

International trade can play a powerful role in poverty reduction in the LDCs. It is important because exports and imports facilitate a process of sustained economic growth, the development of productive capacities and expansion of employment opportunities and sustainable livelihoods. For most LDCs, the primary sector, particularly agriculture, dominates production and employment in the economy, and productive capacities are weakly developed. In this situation, exports enable the acquisition, through importation, of goods which are necessary for economic growth

and poverty reduction, but which are not produced domestically. These include food, manufactured consumer goods, fuel and raw materials, machinery and equipment and means of transport, and intermediate inputs and spare parts. Through exports it is possible to transform underutilized natural resources and surplus labour into imports which support economic growth. Exports must grow fast enough, and in a sufficiently stable way, to meet growing import demand. If they do not, the sustainability of economic growth will be threatened by the build-up of an unsustainable external debt.

International trade is particularly important for poverty reduction in the LDCs because, contrary to popular impressions, their “openness”, measured by the level of trade integration with the rest of the world, is high. During 1999–2001, exports and imports of goods and services constituted on average 51 per cent of the gross domestic product (GDP) of the LDCs. This ratio is somewhat smaller than that for low- and middle-income countries. But the average level of trade integration of the LDCs was actually higher than that of high-income OECD countries, which stood at 43 per cent in those years. In only 10 of the LDCs for which data are available was the trade/GDP ratio lower than that in the high-income OECD countries.

In addition, international trade matters for poverty reduction because the LDC economies are highly “import-sensitive”. The higher the proportion of imports that are essential to the continuation of ongoing economic activities and their development, the higher the import sensitivity of an economy. In LDCs, import bottlenecks hamper the full utilization of domestic productive capacities. In addition, the import content of investment processes is high owing to the absence of a domestic capital goods industry and engineering capabilities. Lastly, for a few LDCs, food security is highly dependent on food imports.

But the relationship between international trade and poverty reduction is neither automatic nor straightforward. There are at least three reasons for this.

First, in poor predominantly natural-resource-based or agrarian economies such as most LDCs, economic growth depends on the

development of a range of new capabilities, institutions and services. New agricultural technologies need to be adapted, or developed from scratch, in conformity with the countries' agro-climatic and soil conditions. Schools, universities, hospitals, technical training centres, and research and development institutions need to be strengthened or set up. Roads need to be built and extension services need to be established to bring the majority of the agricultural population into the orbit of the modern economy. The rule of law needs to be enforced, and the monopolistic activities of particular interests need to be curtailed. In short, there is a need for investment of all kinds of physical, human, social and institutional capital, and innovation and technological progress adapted to the conditions of the countries. Capital accumulation and technological progress are the engine of growth, and international trade is the fuel for the engine. If the fuel dries up, the engine will not run.

Thus sustained economic growth requires not simply export expansion but also a strong investment–export nexus through which imported equipment, raw materials and production inputs are put to good use and lead to continuous improvements in labour productivity in the economy as a whole. Meeting this condition is particularly difficult in the LDCs given the paucity of surplus financial resources available for financing investment and also the weak development of domestic entrepreneurial capacities. Many of the central capital accumulation and budgetary processes in the LDCs are highly dependent on international financial assistance, and thus the link between international trade and poverty reduction also depends on the efficiency and effectiveness of the delivery of international assistance.

Secondly, the positive role of exports in expanding import capacity in the LDCs needs to be seen in the context of the nature of their balance-of-payments constraint. An important feature of LDC economies is that they almost all have persistent and high trade deficits. In the period 1999–2001, the trade deficit was over 10 per cent of GDP in 25 out of 44 LDCs for which data are available, and over 20 per cent of GDP in 8 of them. Excluding oil exporters, which tend to have trade surpluses, export earnings financed only 65 per cent of the LDCs' imports in those years. For the LDCs whose major exports are agricultural commodities, export earnings covered a mere 54 per cent of total imports. These trade deficits

are mainly financed by aid inflows, but workers' remittances are becoming increasingly important.

In these circumstances, it is possible for the positive role of exports in increasing import capacity to be neutralized by declining capital inflows or increased debt service obligations. A major aim of all LDCs should be to reduce their aid dependence and external indebtedness. But in the short run, the link between trade expansion and poverty reduction can be broken if increased trade is seen as an opportunity for reduced aid. If improvements in export performance are associated with decreases in international assistance and increases in debt service obligations, there is a danger of leaving a country running on the same spot despite a major effort to finance its own development.

There is a third reason why the relationship between international trade and poverty reduction in the LDCs is complicated. Although the national economies of most LDCs are highly integrated with the rest of the world through trade, the lives and livelihoods of most people in most LDCs are not directly linked to the international economy. It is difficult to get precise data on this. It is notable, however, that agriculture constitutes over 60 per cent of the labour force in all except 11 LDCs, but the ratio of agricultural exports to agricultural value-added is generally low. Although there are some exceptions, agricultural exports are equivalent to less than 10 per cent of agricultural value-added in more than half the LDCs for which data are available. In the urban centres, wage employment constitutes a very small fraction of total employment in most LDCs. Very little informal-sector activity is export-oriented and although some of it is potentially import-competing, in practice poverty segments the market, creating a niche for domestic producers of goods. Another telling indicator is that for over half of the LDCs, food imports constitute less than 10 per cent of total food consumption.

Against this background, there is no guarantee that export expansion will lead to a form of economic growth that is inclusive. Indeed, there is a strong likelihood that export-led growth will actually turn out to be "enclave-led growth". This is a form of economic growth that is concentrated in a small part of the economy, both geographically and sectorally. It is exemplified by the pattern of development in the colonial

period in African LDCs, where a relatively rich commodity-exporting sector, well connected to roads and ports and supported by ancillary services, existed side by side with large undeveloped hinterlands where the majority of the population lived. But it can also occur with the expansion of labour-intensive manufactures exports confined to an export processing zone based on assembly of imported inputs, or tourism enclaves which are supplied through imports, or capital-intensive extractive industries concentrated in a few localities within a country.

An inclusive form of economic growth requires not simply export expansion but also an economy-wide expansion of income-earning opportunities, encompassing exports and import-competing activities, and non-tradables as well as tradables, which occurs at a rate that exceeds the rate at which the working-age population is growing. What is required is not simply a process of export expansion, but also the promotion of developmental linkages between growing export activities and the rest of the economy. For an inclusive process of economic growth, it is particularly important that the development complementarities between agriculture and non-agricultural activities be strengthened.

## HOW THE TRADE—POVERTY RELATIONSHIP WORKS IN PRACTICE

Although international trade can play a powerful role in poverty reduction in the LDCs, this Report finds that in practice the positive role of trade in poverty reduction is actually being realized in very few LDCs.

The first and obvious reason for this is that there has been a lack of export dynamism in many LDCs. This is closely related to export structure, and in particular commodity dependence. As discussed in detail in *The Least Developed Countries Report 2002*, many non-oil commodity-exporting LDCs have been caught in an international poverty trap in which external trade and financial relations are reinforcing, rather than serving to break, the domestic vicious circles that perpetuate poverty. The non-oil commodity-exporting LDCs generally depend on a narrow range

of low-productivity, low-value-added and weakly competitive primary commodities serving declining or sluggish international markets. A weak export performance has been associated with the build-up of external debt and the emergence of an aid/debt service system in which aid disbursements have increasingly been allocated, either implicitly or explicitly, to ensure that official debts are serviced. These countries have been increasingly marginalized in world trade. In 2001, the share of world exports of goods and services supplied by the LDCs that export predominantly agricultural commodities was just 56 per cent of its level in 1980, and the share supplied by LDC mineral exporters was just 16 per cent of that former level.

International trade cannot work for poverty reduction if export performance is weak. But even when the LDCs have increased their overall export growth rate — as many (including non-oil commodity-exporting LDCs) did in the 1990s — better export performance rarely translates into sustained and substantial poverty reduction. *The relationship between trade and poverty is thus asymmetrical. Although LDCs with declining exports are almost certain to have a rising incidence of poverty, increasing exports do not necessarily lead to poverty reduction.*

## **The frequency of export expansion without poverty reduction**

The basic evidence that the Report uses to show this phenomenon is derived from examination of the trends in real exports and average private consumption per capita (in 1985 purchasing power parity dollars). Within the LDC context, there is a close long-term relationship between average private consumption per capita and the incidence of \$1/day and \$2/day poverty. This enables the identification of three types of trade–poverty relationship:

- A virtuous trade effect, where average private consumption per capita is rising along with export growth;
- An immiserizing trade effect, where average private consumption per capita is falling along with export growth;

- An ambiguous trade effect, where there is no clear trend in average private consumption per capita along with export growth.

This classification is likely to provide the best possible view of the trade–poverty relationship. It is almost certain that the incidence of poverty is increasing in situations where average private consumption is falling. But it may be that, in the short term, increases in average private consumption per capita are concentrated in the richest sections of the population and are not associated with poverty reduction. Deviations from the long run typical relationship between private consumption and the incidence of poverty can arise, but they are unlikely to be sustainable in the long run.

If one focuses on trends in those LDCs for which there are data for 1990–1995 and/or 1995–2000, some positive signs can be seen. Out of the 66 observations (one country in one period), exports grew in 51 of them. If the countries are simply divided into those in which average private consumption per capita is increasing and those in which it is falling, export expansion can be said to be occurring along with rising private consumption per capita in 59 per cent of cases (30 out of 51). Moreover, export expansion with increasing average private consumption per capita was more common in the period 1995–2000 than in 1990–1995. But using a very conservative threshold growth rate of average private consumption per capita (+1 per cent per annum and –1 per cent per annum) to distinguish between situations where there is a virtuous trade effect, an ambiguous trade effect or an immiserizing trade effect, it is clear that the potential role of trade in poverty reduction is not working as expected. To be precise:

- The immiserizing trade effect is present in 18 of the 51 cases.
- The ambiguous trade effect and the immiserizing trade effect, which together account for 29 of the 51 cases, occur more frequently than the virtuous trade effect.
- The virtuous trade effect is present in only 22 of the 51 cases.

Some may wish to see this as a glass half full rather than a glass half empty. However, the fact that there is no statistically significant relationship between export growth and changes in private consumption

per capita in either period should be a matter of concern. Moreover, there are only three LDCs — Bangladesh, Guinea and Uganda — in which the virtuous trade effect is observed during both 1990–1995 and 1995–2000. Poverty reduction in the LDC context can be expected to occur only if there is a sustained and substantial increase in average private consumption per capita. There have been significant export take-offs in a large number of LDCs since the late 1980s. But export growth is simply not having a strong and sustained virtuous poverty-reduction effect in most of the LDCs.

## The trade–growth relationship

One of the reasons why export expansion does not often lead to poverty reduction is the nature of the trade–growth relationship. Generally, there is a positive association between export growth and output growth in the LDCs as in other developing countries. However, the relationship is slightly weaker in the LDCs than in the other developing countries in terms of the closeness of the association between the two variables. Moreover, at any level of export growth, a given export growth rate is associated with a slightly lower output growth rate in the LDCs than in the other developing countries. This turns out to be quite significant because a necessary minimum condition for poverty reduction is that the rate of economic growth is fast enough for GDP per capita to increase. Population growth rates tend to be higher in the LDCs, and in these circumstances, despite the positive relationship between export growth and output growth, export growth is not generating a sufficiently high output growth rate to ensure increasing GDP per capita in a number of LDCs. Indeed, during the 1990s, positive export growth was associated with declining GDP per capita in about a third of the LDCs.

What seems to be important is not simply export growth but a real export growth rate that exceeds 5 per cent per annum. Below that threshold, there is a greater probability that export growth will be associated with declining GDP per capita than with increasing GDP per capita.

The reason why the trade–growth relationship is somewhat weaker in the LDCs than in other developing countries is an issue which requires further investigation. There was actually a very strong relationship between import growth and investment growth in the LDCs in the 1990s. This suggests the possibility of a strong investment–export nexus through increased exports enabling increased imports, increased imports enabling increased investment in the domestic economy, and increased investment leading to higher economic growth. However, the evidence suggests two major missing links in the relationship between exports, imports, investment and economic growth. First, the growth in import capacity in the 1990s was much slower than export growth. This is likely to reflect decreased aid inflows and changes in contractual debt service obligations. Second, increased investment is not as strongly associated with increased economic growth in the LDCs as in other developing countries.

International trade cannot work to reduce poverty in countries where the level and efficiency of investment are not adequate to support sustained economic growth. On the basis of analysis in *The Least Developed Countries Report 2000*, major reasons for the breakdown of the investment–growth relationship are the following: constraints on domestic resource mobilization and the weakness of the domestic entrepreneurial class; aid ineffectiveness; and the multiple negative effects of external indebtedness. Basic conditions for ensuring a better trade–poverty relationship in the LDCs are the emergence of a domestic entrepreneurial class oriented towards productive activities, increasing and effective international financial and technical assistance to build production and trade capacities, and a durable exit from the debt problem.

## **Trade expansion and the inclusiveness of the economic growth process**

The trade–poverty relationship is also breaking down because export expansion is not associated with an inclusive form of economic growth that is poverty-reducing. The limited amount of data makes it difficult to draw general conclusions on the inclusiveness of economic growth. Indeed, there is an urgent need for country case studies on employment

and trade in order to have a better indication of what is actually happening. But this Report finds that immiserizing trade tends to occur more often in LDCs with high levels of income inequality. Moreover, indications from the Diagnostic Trade Integration Studies (DTIS) prepared within the context of the Integrated Framework for Trade-related Technical Assistance for the LDCs (IF) provide important evidence of export-led growth that is not inclusive.

Madagascar can be taken as an exemplar. Its Diagnostic Trade Integration Study includes a simulation which assumes that garments exports will grow at 20 per cent per annum from 2000 to 2003, and then at 10 per cent per annum from 2003 to 2009, and that tourism will grow at 10 per cent per annum throughout the period. But if agricultural production grows at 1.5 per cent per annum, as it did in the 1990s, and domestic industry outside the export processing zone (EPZ) grows at 2 per cent per annum, the projection indicates that the proportion of the population living below the poverty line will rise from 71 per cent in 1999 to 72 per cent in 2009. In effect, export growth rates as high as the best-performing LDCs can expect will be associated with no decline in the incidence of poverty and, given population growth, with an increase in the number of people living below the poverty line of almost 3.8 million in 10 years.

The Report identifies two important factors which affect the chances of achieving an inclusive form of economic growth based on export expansion. The first is the extent to which export expansion, import substitution and domestic demand expansion each contribute to economic growth. The evidence shows that the least favourable trade–poverty relationships in the LDCs in the 1990s tend to be found in countries in which export expansion is the most important demand-side component of economic growth and in countries in which import substitution is the major demand-side component of economic growth. Virtuous trade effects are most likely to occur if there is a balanced pattern of economic growth, in which domestic demand expansion is the major component of economic growth, but export expansion also makes a significant contribution to the overall process.

The second factor is the intensity of the domestic resource mobilization effort. It is a striking fact that two thirds of cases of an immiserizing trade effect or ambiguous trade effect in the LDCs in the periods 1990–1995 and 1995–2000 are related to an increasing domestic resource mobilization effort and a falling share of private consumption in GDP. The domestic resource mobilization effort supporting export expansion is positive from the perspective of growth sustainability to the extent that it is associated with efficient investment. But it is very difficult for such “belt tightening” to occur in very poor countries, where the average consumption of the population as a whole is equivalent to just \$1 a day, without a rising incidence of poverty. Moreover, if the “belt tightening” associated with export expansion becomes too much, it may be that the whole growth process cannot be sustained.

The trade-off between increased domestic resource mobilization, which can help to strengthen export growth, and reduced poverty is a major dilemma in poor countries. It becomes less acute to the extent that average private consumption per capita is not at basic subsistence levels. Moreover, the trade-off between the two desirable goals is loosened if the trade–growth relationship is stronger. But if export growth is associated with slow increases in GDP per capita, as it is in many LDCs, the trade-off is likely to be particularly pronounced. In these circumstances, ensuring that export expansion, increased domestic resource mobilization and poverty reduction all occur together depends critically on the availability of external resources to diminish the trade-off between domestic resource mobilization and poverty reduction.

## **Civil conflict and the trade–poverty relationship**

A further factor contributing to the weak trade–poverty relationship in the LDCs is civil conflict. This is an increasingly important issue in the LDCs. Databases disagree on the precise pattern. But the widely used Uppsala/PRIO database indicates that during the period 1978–1989, 40 per cent of the current LDCs experienced civil conflict of varying intensity and duration, whilst during the period 1990–2001, this proportion increased to 60 per cent.

The causes of this trend are very complex. The analysis in this Report suggests that an export specialization in some products, notably diamonds, oil, timber and narcotic crops, is associated with higher conflict risk. But it is much too simple to suggest that trade opportunism rooted in greed is the key determinant of civil conflict in the primary commodity dependent LDCs. However, the Report has some important findings in terms of the consequences of civil conflict.

Depending on the level of intensity of the conflict and also on whether or not a country has had a previous experience of conflict, it is clear that civil conflicts do not always result in a collapse in trade or even lower levels of exports than in the period immediately preceding the conflict episodes. The absorption components of GDP (domestic consumption and investment) generally decline during conflict. However, there is a tendency for exports to be positive during conflict episodes, and sometimes even higher than in the period preceding the conflict. This is particularly evident in cases of conflict recurrence. It reflects partly the fact that some economic actors increasingly just get on with their business regardless of, and even adjusting to, an environment of repeated conflict.

Overall, civil conflict is clearly a major cause of poverty. But because exports can also expand during civil conflicts, there is a strong tendency for conflict episodes to be characterized by immiserizing trade effects. Civil peace is a necessary condition for a virtuous trade–poverty relationship. Good governance, including good management of the revenues from natural resources, is essential for civil peace.

## **IS IT POSSIBLE TO IMPROVE THE TRADE—POVERTY RELATIONSHIP THROUGH UNILATERAL TRADE LIBERALIZATION?**

The major policy challenge now is to bridge the gap between the powerful role which international trade can play in poverty reduction in the LDCs on the one hand, and the ambiguous or immiserizing trade effects which are occurring in too many LDCs on the other hand. One possible policy solution which could be suggested to improve the situation is to undertake unilateral trade liberalization and thereby increase the “openness” of LDCs’ national economies. But there are two caveats which must be entered with regard to the role this can play. First, there has actually been an extensive process of trade liberalization in the LDCs since the late 1980s. In many LDCs there is not much of a trade liberalization agenda left to implement. Second, the emerging post-liberal trends, although they have both positive and negative aspects, do not indicate that substantial and sustained poverty reduction will occur. On balance, future poverty reduction prospects seem to have worsened.

### **The depth and extent of trade liberalization**

The depth and extent of trade liberalization in the LDCs can be gauged by using the IMF index of trade restrictiveness, which classifies countries according to their average tariff rate and also the extent of non-tariff barriers. From these data it is apparent that very few LDCs have restrictive trade regimes now. In 2002, on the basis of this evidence:

- The average tariff rate of 42 out of 46 LDCs for which data are available was less than 25 per cent.
- The average tariff rate of 36 of these 46 LDCs was less than 20 per cent.
- The average tariff rate of 23 of these 46 LDCs was less than 15 per cent.
- In 29 of these 46 LDCs, non-tariff barriers were absent or minor in the sense that less than 1 per cent of production and trade is subject to non-tariff barriers.

- Twenty-eight of these 46 LDCs had no or minor non-tariff barriers coupled with average tariff rates of below 25 per cent.

The extent and the depth of trade liberalization reflect the wide and long involvement of most LDCs with structural adjustment programmes. As a result, most of the LDCs now have more open trade regimes than other developing countries and as open trade regimes as high-income OECD countries. The whole process has also been undertaken very rapidly in quite a number of LDCs. In some cases, they liberalized faster than Chile did in the 1970s and 1980s. In the case of Rwanda, a recent consultant report recommended that it should declare itself an economy-wide free-trade zone. This was considered to be a practical proposition because its trade policy regime, the report stated with only a little exaggeration, was “not far removed” from that of Hong Kong (China) and Singapore.

## Trade liberalization and short-term poverty trends

The usual view of the relationship between trade liberalization and poverty is that trade liberalization is likely to have adverse effects in the short run, particularly as social groups which formerly benefited from a protectionist tariff regime are exposed to international competition, but that in the long run the effects will be favourable because trade liberalization will increase the growth potential of the economy. The findings of this Report are the opposite, however. Poverty trends during and immediately after trade liberalization in the LDCs are very mixed, and not invariably negative as some claim. But there are many grounds for concern about the long-term effects in terms of both the sustainability of economic growth and its inclusiveness.

The short-term effects of the process of trade liberalization on poverty vary considerably between the LDCs. The few studies which seek to isolate the impact of policy change econometrically show limited positive effects in some countries and limited negative effects in others, with some groups benefiting and others losing in each case. If one focuses on growth rates of exports and average private consumption per capita, it is clear that the trade–poverty relationship improved between the first half of the

1990s and the second half of the 1990s in countries which were “open”, “moderately open” or “restricted”, according to the IMF classification, in 2000. But the greatest improvement came in those that opened moderately during the decade rather than those that opened most. Together with results of the analysis in *The Least Developed Countries Report 2002*, the evidence suggests that there has been a tendency for the countries that have opened more gradually and less deeply to have a better trade–poverty relationship than those that have opened furthest fastest on the one hand, and those that have remained most restrictive on the other hand. This pattern, it should be noted, is related to export specialization as much as to trade liberalization, and also to differences in the speed of trade liberalization in Asian and African LDCs. African LDCs have undertaken deeper and faster trade liberalization than Asian LDCs. But it is the latter that have generally had a better performance in terms of poverty reduction and also have been more successful in developing more market-dynamic manufactures exports, partly through regional trade and investment linkages.

## **Trade liberalization and future poverty reduction prospects**

Whatever the short-term trends, the central issue now is whether the new policy environment is likely to facilitate substantial and sustained poverty reduction in the long run. In this regard, there are some positive elements and some negative elements. For the LDCs which have undertaken deep trade liberalization, comparisons of economic trends before and after trade liberalization indicate that GDP growth rates, export growth rates and investment growth rates are all higher in the post-liberal economic environment. But, given high population growth rates, the rates of economic growth that are being achieved are in many cases not sufficient to yield GDP per capita growth rates that will make a major dent in poverty.

Moreover, there are reasons to believe that the sustainability of the positive growth, export and investment trends is still not assured. First, the rate of domestic savings remains very low and thus the post-liberal countries remain highly dependent on foreign savings, particularly aid.

Secondly, there is evidence of post-liberalization aid fatigue, in the sense that aid inflows tapered off after trade liberalization. The Monterrey Consensus may have reversed this for a number of LDCs. Third, although there are higher export growth rates, the composition of exports is not yet shifting towards a more favourable one with greater specialization in dynamic products and increased competitiveness. Certainly, new export products are emerging, and this, together with a trend towards decreasing export concentration, is a positive sign. But in the post-liberal cases examined in this Report, the effect of the emergence of new products is as yet so limited that overall export performance has not improved sufficiently to reverse marginalization in the world economy. In general, the process of trade liberalization in the LDCs has reinforced specialization in commodity exports rather than promoted a shift to manufactures exports.

Analysis of the impact of trade liberalization on the balance of payments in the LDCs shows that the process has increased both exports and imports, the latter more than the former. In comparison with the situation in other developing countries, the process of trade liberalization in the LDCs has had a more limited effect on both exports and imports. For exports, this is likely to reflect lower export supply responsiveness. For imports, the shift to a liberal trading regime is associated with a fall in aid in the LDCs which in turn has reduced import growth, whilst in other developing countries trade liberalization has been associated with higher private capital inflows after liberalization. Trade liberalization has worsened the trade balance of LDCs. The effect is more limited in the LDCs than in developing countries as a whole because the effect of liberalization on import growth is less. However, given the continuing marginalization of LDCs in global private capital flows, the effect on the trade balance implies that the process of trade liberalization has exacerbated aid dependence. Moreover, to the extent that aid is not provided in grants and is not building up trade capacity, it may have increased the likelihood of a renewed debt crisis in the future.

The inclusiveness of the post-liberal growth process also gives cause for concern. Information in the DTIS makes it clear that a form of economic growth in which expansion is localized within a small geographical and sectoral enclave is becoming a problem in some LDCs whose major

exports are manufactures and mining. With this form of economic growth, there are weak links between the rapidly growing export enclave and the agricultural sector where the majority of the population and the majority of the poor have their livelihoods. In these circumstances, it is possible to have very high rates of export growth but no change in the incidence of poverty.

A further factor that diminishes the inclusiveness of the post-liberal growth process arises because deep trade liberalization at the national border has been undertaken in countries with very weak internal transport and communications infrastructure, weak levels of domestic market integration and a high level of subsistence orientation. In these circumstances, many poor people and poor regions are being left out. Moreover, the liberalization process itself cannot break the vicious circles which reduce the market involvement of rural households and render a large proportion of local output only locally tradable. This is exacerbating the problem of enclave-led growth in countries exporting manufactures, minerals and oil, and it is also particularly evident in agriculture-exporting LDCs with a low population density.

Finally, in agriculture-exporting LDCs with a high population density, such as Rwanda, a different problem is emerging. This problem is increasing population pressure on land, environmental degradation and impoverishment, as farm sizes and yields are too low to support households. The development of non-agricultural employment is necessary in order to relieve the pressure on land. But in the LDCs for which trends are reported in the DTIS, rapid and deep liberalization has been associated with de-industrialization as import-substitution industries collapse when they are exposed to international competition without any prior preparation, and as the processing of primary products before export is cut back. It has proved difficult for the agriculture-exporting LDCs with high population density to develop manufactures or service exports sufficiently as an alternative source of non-agricultural employment, and thus the increasing pressure on land resources continues to intensify.

## **MAKING INTERNATIONAL TRADE A MORE EFFECTIVE MECHANISM OF POVERTY REDUCTION**

The central policy issue facing the LDCs and their development partners now is how to promote development and poverty reduction in a very open subsistence-level national economy situated in a very asymmetrically liberalized international economy. The central recommendation of the Report is that *making international trade a more effective mechanism of poverty reduction in the LDCs requires a development approach in which three pillars work together coherently and synergistically.*

The three pillars of this approach are:

- Better national development strategies which integrate trade objectives as a central component;
- Improvements in the international trade regime, including issues which go beyond the scope of the WTO, to reduce international constraints on development in the LDCs;
- Increased and effective international financial and technical assistance for developing production and trade capacities.

### **PILLAR ONE: BETTER NATIONAL DEVELOPMENT STRATEGIES**

#### **Mainstreaming trade in poverty reduction strategies**

The first key to making international trade a more effective mechanism of poverty reduction in the LDCs is the design of better national development strategies. For most LDCs, this is a question of the formulation and implementation of Poverty Reduction Strategy Papers (PRSPs).

The PRSPs have been criticized because they are said to pay insufficient attention to trade issues. This was true of the first generation of PRSPs that essentially sought to integrate pro-poor public expenditure patterns with deeper and broader structural reforms and the macroeconomic policies adopted in earlier structural adjustment programmes. But the recent PRSPs in the LDCs have been much more growth-oriented. Trade issues are central to these PRSPs. Targets for export growth and import growth appear in all of them as part of the macroeconomic framework. Moreover, although few of the PRSPs have a separate section on trade, they invariably include a range of trade objectives, among which are: increasing openness, increasing competitiveness and diversification; reducing export instability; developing new exports, including high-value agricultural exports, manufactures and tourism; and developing regional trade links. In general, trade development is closely linked in the PRSPs to the issue of private sector development and an improved investment climate. But in general, there are weak links between the overall strategic goals and the priority public actions. Moreover, the trade targets that form part of the macroeconomic framework — which usually assume faster export growth than in the recent past and a low income elasticity of demand for imports — float freely, disconnected from the rest of the content of the PRSP.

The Report proposes a methodology for mainstreaming trade in poverty reduction strategies. The methodology focuses on the balance-of-payments constraint and the changes in the income elasticity of imports and exports which are necessary in order to achieve sustainable growth at rates sufficient for meeting poverty reduction targets. It includes examination of export demand prospects of traditional exports and also the criteria for identifying promising tradable sectors that can help in achieving trade development goals. On this basis, alternative trade policy measures can be explored. This would be most effective within the context of a strong national trade policy process in which a wide range of stakeholders, and particularly the private sector, are involved.

This approach can help to integrate trade into poverty reduction strategies. But as argued in *The Least Developed Countries Report 2002*, the critical challenge is not simply to mainstream trade into poverty reduction strategies, but also to move more closely to development-

oriented poverty reduction strategies that are anchored in a national development strategy. From this perspective, the task of integrating trade into PRSPs is best seen as a two-way mainstreaming of both trade and development within poverty reduction strategies.

## Post-liberal development strategies

A critical challenge facing the LDCs at the moment is how to promote development and poverty reduction in a newly liberalized open economy. Key issues which require innovative thinking are: What is the nature of a post-liberal development strategy? What kinds of public action can facilitate development and poverty reduction in an economy without barriers to international trade? These issues are urgent. As a Permanent Representative to the UN and WTO from an LDC — a person who comes from a country which liberalized the furthest and fastest in the 1990s but still faces pressing problems in raising living standards, ensuring fuller employment and reducing poverty — recently put it in a statement at the WTO, “the majority of us [LDCs] are galloping in the darkness”.

As emerges from the analysis in this Report, it is unlikely that an export-led growth strategy will of itself lead to a virtuous trade–poverty relationship in the LDCs. In the LDCs, where there is mass poverty with most people living at or below income levels sufficient to meet their basic needs, export-led growth is generally synonymous with an exclusionary growth trajectory with benefits concentrated in an enclave. However, an important argument of this Report is that export-led growth is not the only promising open development strategy that can be pursued after trade liberalization. *There are a number of alternative open development strategies in which trade is an element of growth rather than the major source of growth, and which can be implemented in an open-economy trade regime in which incentives are biased in favour neither of exports nor of imports and in which there is no discrimination between agriculture and manufacturing sectors.* Such development strategies are defined here as post-liberal development strategies.

Possible post-liberal development strategies include but are not limited to:

- An export-led growth strategy with a human face, including increased linkages to diffuse benefits, and also a basic needs strategy;
- A balanced growth strategy based on agricultural productivity growth and export-accelerated industrialization;
- An agricultural-development-led industrialization (ADLI) strategy — which includes infrastructure investment and technological progress in agriculture together with forward linkages into processing activities — with an export component;
- Development and diversification through management of mineral revenues;
- Development of natural-resource-based production clusters;
- A triadic development strategy that includes the promotion of competitive tradables, employment-intensive non-tradables and technological change in subsistence-oriented activities to reduce constraints on household labour time.

Export growth is an important component of all these development strategies. But whereas in the first one exports are the major demand-side component of economic growth, the others are open development strategies which seek to achieve adequate export growth rather than export-led growth. In the strategies that seek adequate export growth, domestic demand expansion is an important demand-side component of economic growth. There is thus more balance between domestic demand and export expansion in the process of growth.

At the present time what seems to be emerging in some LDCs, implicitly rather than deliberately, is the first hybrid strategy which combines export-led growth with a basic needs strategy. Within this new, frankly experimental, synthesis, the export-led growth leg of the strategy is founded on trade liberalization, together with “behind-the-border” measures to reduce internal constraints on external trade (such as high transaction costs associated with weak trade facilitation and port infrastructure) and measures to foster linkages so that the effects of export growth reach poorer groups and poorer regions. At the same time, the basic-needs leg of the strategy is increasingly taken up by the LDCs’ development partners, who are allocating development assistance increasingly to meet basic needs.

This strategy is certainly likely to result in a more positive trade–poverty relationship than in a pure export-led growth strategy. However, it remains to be seen whether it will be sustainable. As limited international assistance becomes absorbed more and more in basic needs provision, it is less available for developing the production sectors and for private sector development. The great danger of this strategy is that countries will end with a deepening debt problem.

It is in this context that the relevance of the alternative post-liberal development strategies described in this Report needs to be more broadly debated and explored.

## **Policies for promoting development**

Whatever strategy is followed, new types of policies will be required in order to promote development in the new open trading environment. A key insight which must be grasped here is that, as Jagdish Bhagwati argues, free trade is not the same as laissez-faire. Domestic policies are required to correct domestic distortions, market failures and coordination failures, which are all manifold in very poor countries. Such policies should seek to complement rather than supplant market mechanisms.

In implementing post-liberal development strategies, public policies in LDCs should use market-supporting mechanisms aimed at market creation, market development and market acceleration. These policies must not simply provide the right price incentives, but also create the right institutions and the infrastructure necessary for a modern market economy to function properly. The provision of public goods that address the current gaps and shortages in the productive sectors of LDCs is vital. New investment should also be directed towards increasing the absorption capacity of imported technologies and new techniques of production throughout the economies of the LDCs. Private sector development should be a priority. A major effort must be made to develop a domestic enterprise sector oriented towards production rather than simply exchange. Particular emphasis must be placed on small and medium-sized enterprises, and also new market-oriented approaches to agricultural development need to be devised to fill the vacuum left by the dismantling of old commodity marketing boards.

## **PILLAR TWO: IMPROVING THE INTERNATIONAL TRADE REGIME**

Without improvements in the international trade regime to reduce international constraints on development in the LDCs, the positive effects of better national development strategies will not be realized.

This requires not simply attention to WTO rules but also multilateral norms, rules and practices which go beyond WTO issues. It is necessary to define the international trade regime in these broad terms because in practice, many of the key international problems facing LDCs in terms of the international trade environment are actually outside the WTO agenda. They relate, for example, to the working of the international commodity economy, part of which is affected by WTO issues and part of which is not. Another important issue is the nature of agreements on preferential market access between developed countries and LDCs and between developing countries and LDCs, and also the nature of regional trade agreements. The transparency of mineral rents and revenues is another key issue, and the process of the untying of aid, which is very important for import competition, is being monitored through the OECD Development Assistance Committee (DAC). Against this background, limiting the discussion to WTO issues would considerably foreclose proper analysis of how it is possible to link international trade to poverty reduction in the LDCs through improvements in the international trade regime.

The Report argues that improvements to the international trade regime should encompass (i) measures at a global level that are generally applicable to all developing countries, (ii) special international support measures targeted at the LDCs, and (iii) enhanced South–South cooperation in the fields of trade and investment.

### **Generally applicable measures**

The Report argues that the LDCs cannot be expected to gain much from the current round of multilateral trade liberalization unless

improvements are made in their productive capacities to enable them to benefit from any subsequent global growth. Amongst the issues currently under discussion, the phasing-out of agricultural support measures in OECD countries is particularly important for the development prospects of the LDCs. Although these measures may help countries import cheap foods and meet food security needs in the short term, they have a depressing effect on agricultural production in the LDCs, breaking the potential complementarities between agricultural and non-agricultural development that are central to the development process. The Report identifies rice, sugar, maize, sorghum, wheat, potatoes, cotton, beans and beef and veal as some of the key products that receive support in the developed countries and are also of great importance to production in least developed countries. Even though food imports are a small proportion of total food consumption in many LDCs, the OECD agricultural support measures serve to discourage domestic agricultural production, increasing future dependence on food imports.

However, there are also a number of generally applicable measures, beyond multilateral trade liberalization, which can play a very important role in making international trade a more effective mechanism for poverty reduction in the LDCs. The major sin of omission in the current international approach to poverty reduction is the failure to tackle the link between commodity dependence and extreme poverty. Any measures in relation to commodities are likely to have a high poverty-reduction intensity in the LDCs. Priority areas include general measures to reduce vulnerability to commodity price shocks (for example, linking debt repayment schedules to world prices) and initiatives to ensure international transparency in the revenues derived from oil and mineral exploitation. System-wide measures with regard to the mineral economies, which are off the radar screen in current analyses of the effects of multilateral trade liberalization (which focus on agriculture and manufactures), are likely to be particularly important as extreme poverty has been increasing in most mineral-dependent LDCs.

## Special international support measures for LDCs

Against the background of the potential gains which LDCs are likely to derive from multilateral trade liberalization, special international support measures have an important role to play in making international trade a more effective mechanism for poverty reduction in the LDCs. Current special measures, including both market access preferences and special and differential treatment for the LDCs written into WTO provisions, have various limitations which reduce their effectiveness. There is considerable room for strengthening these measures. For preferential market access, improvements can come through the following: changes in the rules of origin; helping countries to meet sanitary and phytosanitary standards (SPS) and technical barriers to trade (TBT) requirements; wider product coverage; and more stability and predictability, which may be achieved through the binding of market access preferences in a WTO context. Special and differential treatment for LDCs within WTO provisions can be improved through better targeting to countries and problems; a shift from best-endeavour provisions to binding provisions; and closer attention to provisions which help build production and supply capacities, notably the encouragement to WTO members given in the Trade-Related Aspects of Intellectual Property Rights (TRIPS) Agreement to transfer technology to the LDCs. It is also important that acceding LDCs automatically receive the same special and differential treatment as LDCs that are already WTO members.

As multilateral trade liberalization deepens, market access preferences for LDCs will gradually erode and the major market-based approach to supporting the LDCs will be undermined. As this happens it is important to consider complementary international support measures for the LDCs. One possible course of action is to introduce new supply-side preferences, encourage foreign direct investment (FDI), technology transfer and cheaper finance. These could usefully complement preferential market access as a market-based approach to supporting LDCs.

## South–South cooperation

Finally, international trade can be made a more effective mechanism for poverty reduction in the LDCs through increasing South–South cooperation in the field of trade. This has become increasingly important as South–South trade has grown. Other developing countries supplied only 32 per cent of total LDC imports in 1989, but by 2001 this had increased to 56 per cent. However, there is a danger that LDCs may become marginalized in South–South trade as they are in North–South trade. The proportion of total exports of LDCs going to other developing countries only rose from 15 per cent to 34 per cent between 1989 and 2001. The LDCs have a deficit in their international trade with other developing countries which increased from \$5.5 billion in 1990 to \$15.6 billion in 2002.

Measures to reverse the marginalization of LDCs in South–South trade include further use of the Global System of Trade Preferences (GSTP), encouragement of regional FDI from more advanced developing countries directed to the LDCs and of triangular relationships with developed countries, as well as special provisions within regional agreements. In the end, a major obstacle to increased South–South cooperation is the difficulties which the more advanced developing countries face in the global economy. As these difficulties are removed growth in those countries could play a key role in enabling the LDCs to benefit from global growth rather than face persistent marginalization.

### **PILLAR THREE: IMPROVED INTERNATIONAL ASSISTANCE FOR DEVELOPING PRODUCTION AND TRADE CAPACITIES**

The final element of the three-pillar approach is increased and effective international assistance for developing production and trade capacities in the LDCs. Building productive and supply capacities at the national level will contribute to both trade expansion and poverty reduction and play a central role in improving the trade–poverty

relationship in the LDCs. There is a need for massive investment in enhancing the supply capacities of the LDCs and improving their competitiveness. In the approach being advocated here, trade capacity building is central to that process. But it is difficult to separate this activity from assistance to private sector development, and also assistance to the development of production capacities more generally.

The need for international financial and technical assistance arises because of the limited domestic resources available for doing this, the short-term trade-off between domestic resource mobilization and poverty reduction, and also limits to the potential of private capital inflows to meet many of the investment needs. With regard to the latter, there are indeed some encouraging signs in terms of private capital inflows for infrastructure in the LDCs. But these inflows tend to be highly concentrated in a few countries, and also focus on a few localities and sectors, notably telecommunications.

## **The scale of international assistance**

Improving international assistance for the development of production capacities and trade capacities involves both increasing assistance and improving the effectiveness of assistance. With regard to the scale of international assistance, as aid inflows declined in the 1990s there was a compositional shift away from economic infrastructure and services (particularly transport and communications, and energy) and production sectors (agriculture, industry, trade and tourism) towards social infrastructure. In the early 1980s, the share of total bilateral aid commitments by DAC member countries to LDCs that went to economic infrastructure, production sectors and multi-sectoral and cross-cutting issues was 45 per cent. But in 2000–2002 this had fallen to 23 per cent. In real terms, external assistance to agriculture in the LDCs in the 1990s was half the level it was in the 1980s. It is vital that the upturn in international assistance following the Monterrey Consensus be also associated with a shift in the composition of aid back towards building production capabilities and not simply meeting basic needs and providing social infrastructure.

Aid for trade has been particularly neglected. It is difficult to estimate past trends owing to the way in which aid for trade has been defined in the OECD Creditor Reporting System. But over the period 1990-2001, according to this data base, total bilateral and multilateral aid commitments to trade policy and administration to all the LDCs was on average \$13.8 million per year, which was equivalent to 0.1 per cent of total aid commitments. In 7 of those 12 years aid commitments for trade policy and administration were less than \$6 million for all the LDCs. The recently established WTO/OECD database on aid for trade-related technical assistance and capacity-building gives a fuller picture, suggesting higher levels of aid for trade. In 2002, according to the latter database the LDCs received \$75 million for trade policy and regulations, with the key priority being negotiations of Economic Partnership Agreements (post-Cotonou), and \$249 million for trade development, with business support services and market analysis and development being priorities. But to put these in perspective, aid commitments for trade policy and regulation and for trade development were only 0.5 per cent and 1.5 per cent, respectively, of total aid commitments in that year.

A particular priority in terms of financial assistance for trade capacity building is trade-related infrastructure. This should be part of a major effort to meet the quantitative targets included in the United Nations Programme of Action for the Least Developed Countries for the Decade 2001–2010. The lack of any clear definition of trade-related infrastructure means that estimates of the current scale of assistance will vary with the definition. According to the WTO/OECD database, which includes all aid commitments in the areas of transport and storage, communications and energy, the LDCs received \$1.4 billion in 2002, 9 per cent of total aid commitments in that year. Aid commitments for trade-related infrastructure, defined more narrowly as transport, storage and communications, declined by 43 per cent in real per capita terms from 1990 to 2001.

## **The effectiveness of international assistance**

Finally, it is necessary that improvements be made in the effectiveness of assistance. There are three particular problems for the development

partners of the LDCs which need to be addressed here. The first of these is that the development objectives of developed countries in their role as donors overlap with their commercial interests in their role as trading powers. It is important that this does not bias assistance for trade development. The untying of aid to LDCs provides a major opportunity for a culture shift in this regard. Second, there is an urgent need to strengthen donors' own trade-related capacities. Mainstreaming trade in aid programmes is as important and urgent as mainstreaming trade in PRSPs. Third, donors need to elaborate innovative approaches to private sector development in the LDCs. Post-liberal aid policies need to complement post-liberal development strategies.

The major initiative to improve the effectiveness of assistance for trade capacity building is the Integrated Framework for Trade-related Technical Assistance for the LDCs (IF). The diagnostic studies produced through this initiative provide much useful information on trade and poverty in the LDCs, but they have focused more on identifying unfinished trade policy reforms and on trade facilitation and export constraints in particular sectors, and less on how to reduce poverty through trade and development. However, the key feature of the IF is that it has as yet had limited concrete trade capacity-building outcomes.

## **THE NEED FOR POLICY COHERENCE WITHOUT DEVELOPMENT PESSIMISM**

### **The need for policy coherence**

Each of these three pillars is important for success. Improvements in the international trade regime are a necessary condition for success since that regime provides the framework for linking trade more effectively with poverty reduction in the LDCs. However, whether or not the increased opportunity for poverty reduction which can come from such improvements will be translated into reality depends on whether the opportunity is grasped at the national level. The fundamental priority here

is that Governments formulate and implement national development strategies that integrate trade within them in a way that effectively supports poverty reduction. This is pivotal because it is the area where the LDCs themselves potentially have the most leverage to make trade work for poverty reduction. But the development partners of the LDCs also need to support these efforts through international financial and technical assistance to build both public and private trade capacities. Policy incoherence between international assistance policies and national trade objectives, insufficient and biased financial and technical assistance for trade, and the failure to facilitate and nurture national ownership of trade and development policies can all undermine national efforts to grasp opportunities which changes in the international trade regime provide.

This three-pillar strategy to make trade a more effective mechanism of poverty reduction in the LDCs also needs to be embedded within a broad approach to international development policy which encompasses increased trade opportunities, more effective international financial and technical assistance, deeper debt relief, the promotion of private capital flows, and international assistance for technology transfer and acquisition. The challenge of development in the LDCs is so great that it will be counter-productive to see trade as a substitute for aid, or to imagine that private capital flows can substitute for official capital flows in these countries. The goal of the LDCs themselves must be to promote a progressive transition in which sustained economic growth is increasingly founded on domestic resource mobilization, the attraction of developmental FDI and the tapping of international financial markets, and imports are increasingly paid for by exports rather than covered by aid inflows. This is likely to be best achieved if, during this transition, international assistance, debt relief, trade preferences and measures to facilitate FDI and technology transfer all work together to promote development.

What is encouraging at the present time is that there is a wide consensus on better national policies, a better international trade regime and better international assistance for trade capacity building as three key pillars of a broad strategy for making international trade a more effective mechanism of poverty reduction in the LDCs. However to be effective, these three pillars need to be articulated and implemented in the way that

is most appropriate at the present time. This requires shaking off the grip of development pessimism.

## Loosening the grip of development pessimism

In the past, development strategies and international policy recommendations were influenced by both export pessimism and agricultural pessimism. At the present time, development pessimism constitutes one of the greatest obstacles to global poverty reduction.

Development pessimism is apparent in the belief that past development efforts have failed, or that the deliberate, purposeful acceleration of development through policy does not work, or that if it worked in the past it will not work now in the new globalized economic environment. Development pessimism is shared by those who would argue that the State should play a minimal role in guiding economic activity in developing countries, and also those who argue that it should play an important role but cannot do so because international rules reduce “policy space” and thus prevent countries from doing what they need to do. Within an LDC context, weak State capabilities are added as a further ingredient reinforcing the view that development promotion simply cannot be done.

Development pessimism has led to the view that the best way to reduce poverty in the LDCs and other developing countries is not through development but rather through closer integration with the world economy. Global integration certainly must be central to any effective development and poverty reduction strategy in the LDCs. International economic relations can play a key role in helping LDCs to break out of the domestic vicious circles which cause generalized poverty to persist:

- Access to foreign savings can play a catalytic role in helping poor countries to break out of the cycle of low incomes, low savings, low investment, low productivity and low incomes.
- Exporting to international markets enables land and labour resources, hitherto underutilized owing to the weak effective demand associated with mass poverty, to be productively mobilized.

- Increased access to available modern technologies enables latecomers to achieve significant productivity increases without continually having to reinvent.
- Increased FDI can increase investment and provide technology and managerial skills.
- Increased international migration enables poor people in poor countries to find employment abroad even if opportunities are limited in their own country.

However, it is an illusion to think that persistent mass poverty in the LDCs is the result of a lack of integration and insufficient trade liberalization rather than the consequence of underdevelopment.

The policy problem for the LDCs is not the level of integration with the world economy but rather the form of integration. The current form of integration is not supporting sustained economic growth and poverty reduction. The process of trade liberalization has created a new environment for poverty reduction in the LDCs. The central issue now is how the LDCs, supported by their development partners and enabled through a facilitating international trade regime, can promote development and poverty reduction in this new environment.

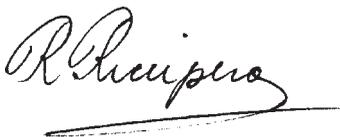
There should be no grounds for development pessimism. One of the most important achievements of the second half of the twentieth century was the lifting of millions of people out of poverty through the promotion of development. Moreover, these achievements are now being continued in China and India. The question is how to make this happen in the LDCs as well.

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To conclude, I would like to emphasize that this Report is part of a wider programme of work which UNCTAD envisages in the area of trade and poverty. There has been intense interest in this subject in the last five years. But so far, the major focus has been on trade liberalization and poverty rather than on looking at trade and poverty from a development perspective. This Report is a contribution to the latter task, providing not simply an analysis of the LDCs but also a possible conceptual framework for a development approach.

The subject of trade and poverty is of immense importance. This is not simply because of the ethical dimension which it brings to the international policy debate but also because it extends trade policy analysis from questions of the quantity of trade to questions of the quality of trade. This notion needs to be elaborated in the same way as the notion of the “quality of growth” and the “quality of employment”, and practical strategies to link trade, development and poverty reduction have to be worked out to meet the needs of developing countries at all levels of development.

There is much to be done.

A handwritten signature in black ink, appearing to read 'R Ricupero', with a long horizontal flourish underneath.

Rubens Ricupero  
Secretary-General of UNCTAD