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Escaping the Poverty Trap

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International policies for more effective poverty reduction in the LDCs

Chapter

6

A. Introduction

Reducing poverty in the LDCs requires action at both the national and the international level. Good national policies are a sine qua non for success in reducing poverty. But good international policies are equally necessary. A good national poverty reduction strategy cannot be fully effective in an adverse international enabling environment. However, significant and sustainable inroads into poverty will certainly follow appropriate and concerted action to tackle both the national and international determinants of poverty in the LDCs. Indeed, joint action is essential to help countries to escape the poverty trap.

Good national policies are a sine qua non for success in reducing poverty.

This chapter focuses on international policies. The Programme of Action for the Least Developed Countries for the Decade 2001–2010 has the function of providing a common framework for development cooperation between LDCs and their development partners. This chapter therefore seeks to identify aspects of the Programme whose implementation seems particularly important given the analysis of the international poverty trap in this Report. It examines, in particular, the role of debt relief, aid, preferential market access and international commodity policy in supporting the LDCs, as well as the need for increased policy attention to the role of regional dynamics in poverty reduction.

The analysis is founded on the view that the most effective way to reduce poverty in the LDCs is a multi-level approach (see box 18). The discussion of international policies in this chapter thus needs to be seen alongside the national policies discussed in the previous chapter. They are not put forward as "stand-alone" policies; rather, they will work for poverty reduction when they are implemented together with, and in support of, national policies of the type discussed in the previous chapter. Increasing the positive synergies between national and international policy is crucial for effective poverty reduction.

The most effective way to reduce poverty in the LDCs is a multi-level approach.

B. The need for re-enhanced debt relief

Unsustainable external debt is a central ingredient of the cycle of economic stagnation and persistent generalized poverty in poor countries. The wide acceptance of this relationship formed the basis of international agreement on the need for comprehensive debt relief for poor countries, which led to the establishment of the HIPC Initiative in 1996 and its enhancement in 1999. A first necessary condition for many LDCs to escape the poverty trap is that there be a durable exit from the debt problem.

Unsustainable external debt is a central ingredient of the cycle of economic stagnation and persistent generalized poverty in poor countries.

Through the enhanced HIPC Initiative, the present value of the stream of future debt service payments, which the LDCs that are also HIPCs (HIPC-LDCs) would have been contractually obliged to make, has been significantly reduced. According to January 2002 estimates, the total reduction in future debt service obligations for all HIPCs thus far is equivalent to around $25 billion in net present value (NPV) terms, and that for HIPC-LDCs can be estimated at around

Box 18. A multi-level approach to poverty reduction policy

The causes of poverty can be identified at different levels of aggregation, running from the local to the global (Pyatt, 1999, 2001). As a corollary, effective poverty reduction requires a multi-level approach in which policies at different levels complement and reinforce each other.

Box table 3 below sets out a policy framework for locating the causes of poverty and for identifying areas of action within a multi-level approach to poverty reduction. The three basic (and most familiar) levels of policy within this framework are local/micro, national/macro and international/global. But the framework also includes the national/meso level and the international/regional level. Elements of the national/meso level are the following: the markets in which households operate (labour markets, credit markets, product markets, insurance markets); the social and economic infrastructure which they use, including health and education services, the transport and communications infrastructure, utilities, irrigation facilities and agricultural extension services; and the regional and sectoral structure of the national economy. These elements are included in the policy framework as various analysts have found that they constitute an important link between macro and micro trends within national economies (World Bank, 1990; Stewart, 1995; ECLAC, 1996; Gore and Figueiredo, 1997). The international/regional level is likewise included as this level is important for understanding links between the global economy and national economy. Elements of the international/regional level include trade, investment and migration linkages, common international transport services and infrastructure structures, and various regional cooperation regimes.

Box Table 3. A multi-level framework for effective poverty reduction policies

Level		
International	(i)	Global markets for goods and services
	(ii)	Financial markets — aid, debt, private capital flows
	(iii)	Technology transfer
	(iv)	Governance and the global economy
	(v)	Global public goods
Regional	(i)	Trade and investment dynamics
	(ii)	Technical cooperation
	(iii)	Transport systems
Macroeconomic	(i)	Monetary policy — the exchange rate and the rate of interest
	(ii)	Fiscal policy: (a) public expenditure and its financing; and (b) the incentive system (including trade policy and the tax system)
	(iii)	Governance of the national economy — role of the executive, legislative and judicial branches of government in relation to each other and the private sector; and the quality of their performance
Mesoeconomic	(i)	Markets for goods and services — commodities and factors of production (land, labour, etc.)
	(ii)	Financial markets (credit)
	(iii)	Inter- and intra-sectoral allocation of public expenditure
	(iv)	Sectoral composition of growth
Microeconomic	(i)	Individuals, households and their micro-enterprises
	(ii)	Communities and non-governmental organizations
	(iii)	Corporate enterprises

Source: Based on Pyatt (1999).

The focus of policy at the micro level is likely to be on the assets of the poor and the productivity and security of those assets. A particular concern may be improving the human capital of the poor, as well as seeking to enhance community development, but enterprise development is also important. Analysis at the national/meso level will suggest that the focus of policy should be on addressing problems associated with non-existent or incomplete markets and imperfections in established markets, on the structure of public expenditure and delivery systems of public services, and on the transformation of national production structures away from activities for which there is low elasticity of demand and few opportunities for productivity growth. At the national/macro level, key aims of poverty reduction will be to promote rapid and sustainable economic and employment growth without excessive inflation. Key policy issues will be fiscal and monetary policy, exchange rate policy and patterns of governance, the latter being understood here to refer to the balance between public action and private enterprise and the degree

Box 18 (contd.)

of decentralization/devolution. Population policy may also be significant. Analysis at the regional/international level may suggest the need for various forms of regional cooperation to provide regional public goods, for example in environmental management or transport services, and to establish regional regimes regulating trade, investment and migration, and reducing vulnerability to instabilities in the global economy. Finally, analysis at the global/international level is likely to focus on debt relief policies, ways of increasing aid flows and aid effectiveness, the promotion of private capital flows and making international trade work for poverty reduction.

Some would argue that the ultimate causes of poverty are to be found at the micro level in the behaviour of individuals. Others suggest that the key cause is national economic growth and macroeconomic policies. Still others argue that the ultimate causes of poverty are found in the international arena, not in the countries themselves, and that particularly with globalization, countries are subject to global forces which are beyond the control of national Governments. These disagreements, which stem from different frames of analysis, are a major source of disagreement in the policy debate about poverty reduction strategies. A balanced view would suggest, however, that the causes of poverty are found at all levels. It follows that the design of a poverty reduction strategy needs to address determinants of poverty at each and every level. There is a need for a comprehensive multi-level approach, which extends from the local/micro level up to the international/global level, if poverty reduction is to be most effective.

Two negative consequences follow if poverty reduction policies are framed only at the local or national level. First, the amount of poverty reduction that can be achieved through policy action is diminished. Second, there can be misleading policy solutions owing to the existence of fallacies of composition. These fallacies occur when relationships in aggregate differ from those observed at the individual level. Thus the efficacy of local poverty reduction projects is constrained by national policies, and the efficacy of national poverty reduction strategies is constrained by international policies. Households will be able to do much more for themselves if markets are functioning, jobs are becoming available and public services are improving. National Governments will be able to do much less for their citizens if global policies constrain export growth, increase the instability of private capital inflows or bias technological development against the very poor.

Equally, however, the efficacy of international policies can be improved by effective national policies, and national macroeconomic policy performance can be improved by good meso-economic policies and by strong local development efforts. Opportunities for poverty reduction will be maximized through a multi-level approach.

$15 billion. But in absolute terms, debt service relief in the near future is less impressive. For the 20 HIPC-LDCs that have reached decision point, debt service due in 2003–2005 (after the full use of traditional debt relief mechanisms and assistance under the enhanced HIPC Initiative) is, in total, $371 million less per year than debt service paid in 1998–2000. Out of 20 LDCs that have reached decision point, debt service payments due in 2003–2005 will be higher than those paid in 1998–2000 in four cases, and for a further six countries, the reduction in debt service payments will be less than $15 million. The reduction of debt service payments exceeds $50 million in only three countries — Madagascar ($53 million), Senegal ($65 million) and the United Republic of Tanzania ($69 million).[1]

Out of 20 LDCs that have reached decision point, debt service payments due in 2003–2005 will be higher than those paid in 1998–2000 in four cases, and for a further six countries, the reduction in debt service payments will be less than $15 million... Annual debt service relief in 2003–2005 for the 20 HIPC-LDCs that have reached decision point is only 5.5 per cent of net ODA disbursements to those countries in the year 2000.

These resources can certainly contribute to poverty reduction by enabling Governments to increase social expenditures on health and education, as well as to provide resources for decentralized local initiatives. However, the magnitude of resources released in this way is quite small compared with levels of aid inflows (see OECD, 2000: table 1-23; UNCTAD, 2000a, 151–154). For example, annual debt service relief in 2003–2005 for the 20 HIPC-LDCs that have reached decision point is only 5.5 per cent of net ODA disbursements to those countries in the year 2000. Thus, the way in which the HIPC Initiative can contribute most to poverty reduction is less through the resources released by debt relief than through enabling a durable exit from the debt problem and thus increasing growth prospects, improving private sector investment expectations and enabling aid to be used effectively for development purposes.

Unfortunately, current expectations that the enhanced HIPC Initiative will provide a durable exit from the debt problem are unrealistic. For HIPC-LDCs two problems are apparent. First, there are 13 HIPC-LDCs that have still not reached decision point, and 11 of these are considered likely to require HIPC assistance to make their debts sustainable.[2] Second, and this will be the focus of attention here, the forecasts that the debt relief which is agreed at HIPC decision and completion points will lead to a durable exit from the debt problem are over-optimistic. This was identified as a central weakness of the enhanced HIPC Initiative in the last *Least Developed Countries Report* (UNCTAD, 2000a: 154–158). Since then, other evidence and research have confirmed that judgement.

Current expectations that the enhanced HIPC Initiative will provide a durable exit from the debt problem are unrealistic...

Table 44, based on IMF/World Bank estimates, shows some of the main assumptions that underpin projections of external debt indicators in HIPC-LDCs that had reached decision point by April 2001. Forecasting is, of course, a difficult art. But it is clear that the expectations that current levels of debt relief will lead to future debt sustainability are generally based on the assumption that through the enhanced HIPC Initiative there will be higher economic growth and higher export growth in the period 2000–2010 than in the period 1990–1999, generally with less external finance (grants plus new borrowing) as a ratio of GDP and a higher grant element in loans. More precisely:

- Real GDP growth rates are expected to be higher in 2000–2010 than in 1990–1999 in 15 out of 17 countries.
- Export growth rates are expected to be higher in 2000–2010 than in 1990–1999 in 14 out of 17 countries.
- New borrowing, as a percentage of GDP, is expected to be lower in 13 out of 17 countries.
- Grants, as a percentage of GDP, are expected to be lower in 13 out of 17 countries.
- External finance, as a percentage of GDP, is expected to be lower in 14 out of 17 countries.
- The grant element in borrowing is expected to be higher in 2000–2010 than in 1990–1999 in all 16 countries for which there are data.

...Real GDP growth rates are expected to be higher in 2000–2010 than in 1990–1999 in 15 out of 17 countries. Export growth rates are expected to be higher in 2000–2010 than in 1990–1999 in 14 out of 17 countries.

An important question is by how much future trends must deviate from these forecasts before the external debt once again becomes unsustainable. As shown in UNCTAD (2000a), some LDCs would not become sustainable, according to the HIPC criterion of a NPV debt-to-export ratio of 150, before 2005, given current levels of debt relief, even if the optimistic projections were realized. More recent work, which contains a sample of 17 LDCs, shows that 6 out of the 17 will be unsustainable during 2000–2005 even if the optimistic forecasts are realized (Martin, 2001), and it can be estimated that in a further three cases, export growth rates over the period 2000–2005 have to be more than double those of the 1990s for countries to maintain debt sustainability. Close examination of the cases of Burkina Faso and Zambia shows that, in the former case, the NPV debt-to-export ratio will reach 257 per cent in 2010 if export volume growth follows the trend in the 1990s and cotton prices do not recover from their levels in 2001, and in the latter case the NPV debt-to-export ratio will reach 270 per cent if the last decade's trends in the volume and price of copper exports persist (EURODAD, 2001) (chart 47). Future debt sustainability is also quite sensitive to the concessionality of new financing. Scenarios are available in decision point documents for nine LDCs. In four of them the downside scenarios indicate that the NPV debt-to-export ratio would be 40 percentage points higher

TABLE 44. ASSUMPTIONS UNDERLYING MEDIUM-TERM PROJECTIONS IN DEBT SUSTAINABILITY ANALYSIS OF HIPC-LDCS THAT HAVE REACHED DECISION POINT

(Percentage per annum)

	Real GDP growth		Export growth[a]		Grants % GDP		New borrowings % GDP		% Grant element in borrowing	
									Existing debt at	New borrowing
	1990–1999	*2000–2010*	*1990–1999*	*2000–2010*	*1990–1999*	*2000–2010*	*1990–1999*	*2000–2010*	*End-1999*	*2000–2010*
Benin	4.3	5.5	4.9	7.4	4.0	4.0	3.1	2.0	31.8	52.8
Burkina Faso	3.6	5.9	2.4	9.7	4.7	1.6	4.3	3.3	40.0	55.2
Gambia	3.0	5.6	4.2	6.9	10.1	5.1	7.5	5.5	42.9	52.1
Guinea	3.9	5.3	0.6	7.8	4.0	2.8	4.9	4.7	28.4	70.3
Guinea-Bissau	0.3	7.0	7.3	12.1	10.8	10.3	21.6	3.5	25.0	53.4
Madagascar	1.8	6.2	8.0	8.4	3.0	3.5	3.0	3.0	32.5	51.3
Malawi	4.0	4.4	5.5	4.3	6.8	5.6	10.2	5.2	43.2	71.5
Mali	3.4	5.0	5.8	6.3	7.5	4.1	7.5	4.1	..	55.5
Mauritania	4.3	7.3	2.1	6.0	10.2	8.8	12.0	5.5	24.0	50.6
Mozambique	6.3	5.9	10.1	13.0	15.8	5.5	8.6	4.5	57.1[b]	77.5
Niger	2.4	4.4	-3.9	5.4	6.5	4.0	1.5	7.2	32.5	79.5
Rwanda	-1.6	6.1	-2.3	13.7	18.2[c]	5.2[d]	3.9	15.6	44.8	67.1
Sao Tome and Principe	-0.5	4.1	3.4	9.5	38.9	26.9	40.8	12.8	35.2	70.0
Senegal	3.0	5.0	2.8	6.7	6.0	1.7	5.4	2.3	32.1	63.4
Uganda	6.7	5.6	14.6	10.3	2.6	4.0	12.1	3.1	10.1	69.2
United Rep. of Tanzania	3.1	5.9	10.8	10.3	7.1	7.7	0.9	4.7	27.7	57.9
Zambia	1.0	5.2	-2.3	9.6	10.6[e]	5.0	12.7	6.5	22.6	53.6
Simple average	2.9	5.6	4.4	8.7	9.8	6.2	9.4	5.5	33.1	61.8

Source: IMF/World Bank (2001a: table 5, p.24).
a Annual average growth rates of goods and non-factor services exports (in nominal $).
b End-1998.
c 1992–1999.
d 2000–2006.
e 1990–1998.

over the projection period 2000–2020 if financing terms deteriorated (IMF/World Bank, 2001a).

The enhanced HIPC Initiative is on a knife-edge. The optimistic projections are based on "a policy scenario that assumes a country will strengthen its growth potential by sustaining sound macroeconomic, structural and social policies and that the financial requirements associated with this scenario will materialize on the envisaged terms" (IMF/World Bank, 2001a: 22). However, experience suggests that these policies will not achieve this, particularly if there is an unsustainable external debt. Durable exit from the debt problem is possible if the policies can strengthen economic growth. But the debt problem continually undermines the ability of the policies to have this effect. Thus highly indebted poor countries, as well as creditor countries, can get locked into a repetitive pattern of perpetual economic adjustment to achieve the ever-elusive goal of external viability.[3]

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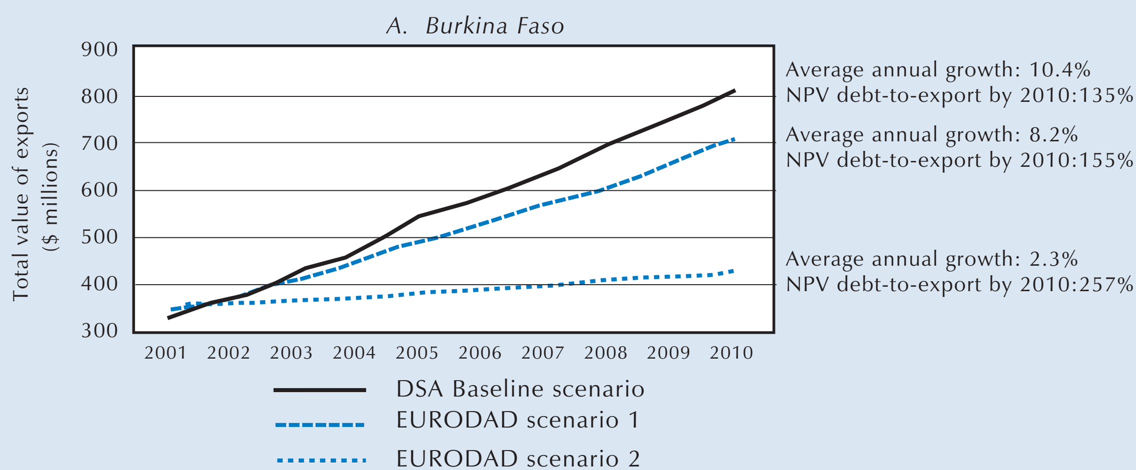
There is some official recognition that the forecasts underlying the expectation that current debt relief is sufficient for a durable exit from the debt problem are over-optimistic. Debt sustainability analyses are re-calculated at HIPC completion point, and additional debt relief is provided if a country's external circumstances have changed significantly (IMF/IDA, 2001). But further and bolder action is necessary to ensure long-term sustainability.

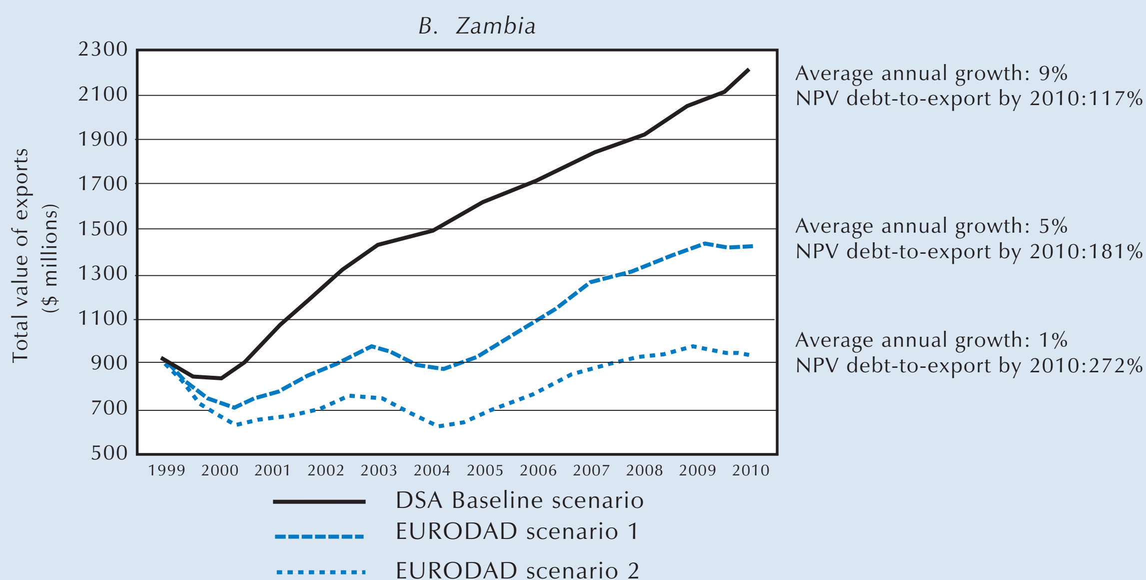
CHART 47. ALTERNATIVE SCENARIOS OF FUTURE EXPORT VALUE IN BURKINA FASO AND ZAMBIA



ASSUMPTIONS UNDERLYING SCENARIOS: BURKINA FASO, 2000–2010

(Average annual percentage growth rate)

	Cotton volume	Cotton price	Gold volume	Gold price	Residual[a] value
DSA baseline scenario	6.0	3.4	9.0	3.0	9.7
EURODAD scenario 1	2.0[b]	0.0	5.0	0.0	9.7
EURODAD scenario 2	2.0	0.0	5.0	0.0	2.4[b]



ASSUMPTIONS UNDERLYING SCENARIOS: ZAMBIA, 2000–2010

(Average annual percentage growth rate)

	Copper volume	Copper price	Residual[a] value
DSA baseline scenario	6.0	4.0	9.0
EURODAD scenario 1	3.0[c]	0.0	9.0
EURODAD scenario 2	7.0[b]	0.0	9.0

Source: EURODAD (2001).
a Growth rate of export value of exports of goods and services other than major commodities.
b 1990–1999 average.
c Moderate projection.

At the Fifth HIPC Ministerial Meeting, held in Maputo in November 2001, HIPC Finance Ministers made a number of concrete proposals in this regard. They urged the international financial community:

- To conduct comprehensive assessments of the debt sustainability of all HIPCs, not simply at decision point and completion point, but afterwards as well;
- To aim well below the current HIPC sustainability targets in these assessments in order to ensure long-term sustainability;
- To take account of shocks affecting countries by introducing new measures to combat them, by interpreting policy conditionality more flexibly in the event of shocks, and by factoring shocks more realistically into debt sustainability macroeconomic projections;
- To examine domestic and private sector debt burdens in all future debt sustainability analyses in order to have a picture of total national debt sustainability, and to convene an international forum to examine ways and means of addressing domestic debt problems, which are severely damaging the private sector, growth prospects, government financing, poverty reduction spending, and therefore the sustainability of external debt (HIPC Finance Ministers, 2001: 3).

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The HIPC Finance Ministers also urged the international financial community to make more efforts to ensure that countries which have passed decision points are able to reach their completion points rapidly by interpreting with maximum flexibility compliance with existing conditions, reducing conditionality in PRGF and PRSC programmes, not introducing new conditions and providing more predictable and transparent guidelines on compliance and reporting. They also urged all creditors to accelerate and increase debt relief by:

- Front-loading relief more comprehensively both before and after completion points;
- Accelerating the implementation of interim relief agreements to ensure that faster fiscal relief is provided immediately after decision point in line with popular expectations created by HIPC II;
- (For multilateral creditors) Providing interim relief on all loans before the completion point and cancelling 100 per cent of multilateral debt at completion point;
- (For bilateral creditors) Adopting a policy of holding debt service payments in trust for countries which are yet to reach decision points, and cancelling 100 per cent of all bilateral debt service at decision point and 100 per cent of stock at completion point;
- Including all pre-cut-off-date debt in debt for relief, and moving the cut-off-date debt and cancelling post-cut-off-date debt where necessary;
- Maximizing the additionality of all debt relief by reducing diversion of bilateral aid and using more of multilateral organizations' own resources;
- Making more rapid progress on debt relief from non-Paris-Club Governments by convening an international conference of HIPCs, international financial institutions, and non-OECD and other bilateral creditors in order to agree mechanisms for ensuring relief comparable to that provided by the Paris Club, using the IDA buy-back facility, the HIPC Trust Fund or other resources;
- (For those HIPC-LDCs which have not reached decision point) Making increased efforts to reduce the time it takes to reach decision point, by

> reducing conditionality and being flexible in interpreting track records, and by reintegrating post-conflict countries much more rapidly into the HIPC process (HIPC Finance Ministers, 2001: 3).

These proposals are concrete measures whose implementation in HIPC-LDCs would fulfil key commitments of the Programme of Action for the Least Developed Countries for the Decade 2001–2010 (set out in United Nations, 2001a, paras. 85–87), which are oriented towards a "comprehensive solution to the debt problem, including full, speedy and effective implementation of the enhanced HIPC Initiative and other debt relief measures" (ibid., para. 86). However, it is likely to be necessary to go further. All members of the Panel which prepared the Zedillo Report (United Nations, 2001b) agreed that "a re-enhanced HIPC Initiative, an HIPC3…merits serious consideration" (p. 54). It would obviously be preferable that further writing-off of external debt happens now rather than that highly indebted LDCs and other poor countries remain stuck in a pattern of ever-recurrent debt renegotiation because sustainability targets of the enhanced HIPC Initiative (HIPC II) are unrealistic. The international conferences proposed by the HIPC Finance Ministers could be an important step towards this, as well as UNCTAD's long-standing proposal, first put forward in UNCTAD (1998), for an objective and comprehensive assessment, by an independent panel of experts not unduly influenced by creditor interests, of debt sustainability, eligibility for debt reduction and the amount of debt reduction needed. The close association between falling and volatile commodity prices and unsustainable external debt should be included in discussions, and ways and means of breaking the link, which is central to the international poverty trap, should be explored. Proposals such as state-contingent debt repayment contracts, which link debt service payments to the external environment in terms of world commodity prices, merit some consideration (Nissanke and Ferrarini, 2001).

There is a close association between falling and volatile commodity prices and unsustainable external debt. Ways and means of breaking the link, which is central to the international poverty trap, should be explored.

Whatever debt relief is provided, it is important that it does not subtract from ODA resources, and also does not impose any unfair burdens on less heavily indebted LDCs and other developing countries. Serious attention must thus be given to the issue of financing further debt relief.

Finally, as discussed in earlier Least Developed Countries Reports, and emphasized in the new Programme of Action (United Nations, 2001a: para. 87(ii)(f)), there is a need to continue to review and monitor the debt sustainability situation of LDCs which are not HIPCs. Some of these are considered to be severely and moderately indebted according to the World Bank classification. One of the principles of the HIPC Initiative was that debt relief should be targeted at the poorest member countries for which excessive debt was a particularly formidable obstacle to development. If any LDCs prove to have unsustainable external debts, they should be eligible for treatment comparable to that accorded to the HIPC-LDCs.

C. Aid and its effectiveness

A durable exit from the debt problem cannot be achieved through debt relief alone, but also requires the provision of aid. Aid is essential for the simple reason that in countries where there is generalized poverty, there are limited domestic resources available for financing physical capital formation, the build-up of the human capital base through better health, education and nutrition, the maintenance of environmental resources, and the adequate funding of public services, including administration and law and order. With many people living

from hand to mouth, and with a weakly developed domestic corporate sector, domestic savings are necessarily very low. External finance is necessary in order to enable countries to break out of the trap of generalized poverty and to initiate a sustained process of development, with increasing reliance on domestic resources and movement away from aid dependence.

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Private capital flows can make a contribution, but this will generally be small in the early stages. Although such flows to the LDCs were increasing in the 1990s, a large share of the increase has been concentrated in a few countries. In spite of extensive efforts to create the right policy environment for private capital inflows from abroad, foreign investors and lenders are generally deterred from placing their money in the LDCs owing to the high costs of asset development, high risks which are rooted in the vulnerability of LDCs to shocks, lack of business support services, weak physical, social and administrative infrastructure, and the small scale of most projects. International capital markets are also characterized by imperfections that limit access to private finance even when projects are financially viable. Thus most LDCs must still rely on official capital flows as their main source of external finance for the immediate future. Aid has a vital role to play in ensuring that countries have access to necessary finance for public sector and private sector development needs when international capital market failures effectively exclude them.

With sustained economic growth there can be a strong domestic savings effort in the LDCs, which could reduce dependence on external finance (UNCTAD, 2000a). Similarly, over time, FDI and international bank loans could increasingly substitute for official grants and loans. But generally private capital inflows are most likely to follow rather than lead economic growth and increased domestic investment. Official development finance is essential to enable countries to break out of the trap of generalized poverty and to initiate a sustained process of development and movement away from aid dependence.

Although development aid is essential for LDCs, in real per capita terms, net ODA disbursements to the LDCs dropped by 46 per cent between 1990 and 2000.

1. The need to implement aid commitments

Although development aid is essential for LDCs in order to enable them to break out of the poverty trap, the actual level of aid inflows was declining in the 1990s. In real per capita terms, net ODA disbursements to the LDCs dropped by 46 per cent between 1990 and 2000. In the latter year, 18 per cent of aid was absorbed in debt relief and emergency assistance. It is also clear that aid inflows have been falling even in LDCs that have what are regarded as a good policy environment. Net ODA per capita to HIPC-LDCs which have reached decision point (which requires a good policy track record in the terms of the IMF and World Bank) has fallen by 35 per cent in real terms from 1990 to 2000, and has fallen by 25 per cent since 1995, the year before the HIPC Initiative was set up.[4]

Aid inflows have been falling even in LDCs that have what are regarded as a good policy environment.

Effective poverty reduction in the LDCs requires that these trends be reversed, and that there be a substantial increase in aid to the LDCs. The levels of aid inflows that are required in order to promote sustained poverty reduction in the LDCs are best assessed through country-level studies. However, various relevant international estimates have been made of the official finance needed to promote sustainable growth and to achieve international development targets in developing countries or sub-groups amongst them:

- UNCTAD (2000b) suggests that for self-sustained growth rates of 6 per cent a year in sub-Saharan Africa to be achieved, aid will have to double in the short run from about $10 billion to $20 billion a year. This increase is necessary in order to give a big push to development now, so as to initiate

a virtuous process in which economic growth is increasingly financed by domestic resources and private capital inflows. The precise magnitude of the aid inflows required depends on marginal savings rates and investment efficiency, and a necessary condition for success is the adoption of more growth-oriented policies at the national level.

- World Bank/IMF (2001) has made preliminary estimates of the increased aid that will be required if the international development goal of reducing poverty by half by the year 2015 in 65 low-income countries is to be achieved. These countries — which are designated "uphill" countries, since it will be an uphill struggle to reach the poverty reduction goal — have an average income per capita of below $400 and consist of IDA-only countries plus Pakistan, Nigeria and Zimbabwe. About two thirds of them, 43 countries, are regarded as having good policies in place now. It is estimated that reducing the incidence of extreme poverty by half in these countries will require that annual aid inflows be increased threefold, from $19 billion in 1999 to $58 billion a year in the medium term (additional funding of $39 billion a year). A similar threefold increase, from $5 billion in 1999 to $15 billion a year in the medium term, is also required in the 22 other "uphill" countries, but such inflows are not recommended by the World Bank and IMF unless those countries' domestic policies are changed. For other developing countries, which can be expected to reach the poverty reduction goal if trends manifested in the 1990s continue, it is recommended that net ODA flows, which amounted to $33 billion in 1999, be maintained at the same level.

Earlier UNCTAD research suggests that for self-sustained growth rates of 6 per cent a year in sub-Saharan Africa to be achieved, aid will have to double in the short run from about $10 billion to $20 billion a year.

From these estimates it is clear that a substantial increase in aid inflows is necessary for the purpose of reducing the incidence of extreme poverty by half in the LDCs. Indeed, it is most likely that attaining this goal will require aid inflows to double at least, and, according to the higher World Bank/IMF estimate, to triple.

Some estimates are also available of the additional resources required for the achievement of education and health goals envisaged in the Millennium Development Goals in the LDCs. On the basis of a UNICEF study it can be calculated that there is a need for additional financial resources (from domestic sources and external finance) of $1.8 billion a year (in 1998 prices) for the achievement of the goal of universal primary education in the LDCs by 2015 (Delamonica, Mehrota and Vandemoortele, 2001). The Commission on Globalization and Health of the WHO has also estimated that $17 billion a year up to 2007 (in 2002 prices) will be required from domestic and external sources for the achievement of the targeted health improvements in the LDCs (WHO, 2002).[5]

To achieve the necessary increase in aid inflows, it is essential that donor countries implement, as soon as possible, commitments which they reconfirmed at the Third United Nations Conference on the Least Developed Countries to reach the target of providing 0.15 to 0.20 per cent of their GNP as ODA to the LDCs.

To achieve the necessary increase in aid inflows, it is essential that donor countries implement, as soon as possible, commitments which they reconfirmed at the Third United Nations Conference on the Least Developed Countries to reach the target of providing 0.15 to 0.20 per cent of their GNP as ODA to the LDCs. Some indicative estimates of aid flows to the LDCs that would follow implementation of commitments are shown in table 45. The table contains only indicative estimates as it is not completely clear which donor countries have committed to the 0.20 per cent target, which have committed to 0.15 per cent, and which have not committed to either target.[6] However, it provides an indication of the order of magnitude of aid inflows, it being assumed that the pattern of commitments to the Programme of Action donor targets which prevailed after the Second United Nations Conference on the Least Developed Countries (when the targets were first set) still obtain and are now fulfilled.

TABLE 45. PROJECTED NET ODA DISBURSEMENTS BY OECD/DAC DONORS TO LDCS IN 2005 ACCORDING TO DIFFERENT SCENARIOS[a]

(Constant 2000, $ million)

	2000[b]	2005
Scenario 1:		
If OECD/DAC donors continue the overall ODA trend decrease of the 1990s	12 211	9 862
Scenario 2:		
If OECD/DAC donors maintain their ODA levels of 2000	12 211	13 916
Scenario 3:		
If OECD/DAC donors gradually fulfil their ODA targets by 2010	12 211	17 886
Scenario 4:		
If OECD/ DAC donors gradually fulfil their ODA targets by 2007	12 211	19 915
Scenario 5:		
As scenario 3, and if Japan and the United States increase their ODA to 0.15% of their GNP	12 211	27 037
Scenario 6:		
As scenario 4, and if Japan and the United States increase their ODA to 0.15% of their GNP	12 211	33 641

Source: UNCTAD secretariat estimates based on OECD/DAC Statistical Reporting System, on-line data.

a For assumptions underlying the projections, see text.
b Actual net ODA disbursements in 2000.

The table underlines the importance of implementation of the aid targets in the Programme of Action. It shows that net ODA flows to LDCs will fall by 19 per cent in real terms to $10 billion (in 2000 dollars) by 2005 if the trends manifested in the 1990s persist, and they will only rise modestly to about $14 billion if there is no change in ODA/GNP ratios from the 2000 level. However, a 63 per cent increase of aid over 2000 inflows can be achieved by 2005 if all donors except Japan and the United States seek to implement the 0.15 per cent and 0.20 per cent targets by 2007. The level of increased aid inflows which the World Bank and IMF are estimating to be required to achieve the international poverty reduction target in "uphill" countries would be impossible to achieve unless Japan and United States, who are the largest aid donors to LDCs in absolute terms, also undertake to provide at least 0.15 per cent of their GNP as ODA to the LDCs. If they were to adopt this policy, progressively moving to that target by 2007, and other donor countries fulfilled commitments by 2007 as before, it would be possible to increase aid inflows by 176 per cent by 2005.

Such increases in the volume of aid require the rebuilding of political support for aid programmes in donor countries. There were encouraging developments in the Monterrey Conference on Financing for Development.[7] But as the Zedillo Report points out, the public in the donor countries need to be made aware of the stake which they have in sustainable development and poverty reduction in the poorest countries, as well as of the resource costs of development and poverty reduction and the role of aid in their financing (United Nations, 2001b: 54). It is also vital that the LDCs themselves regain donors' confidence and build the support of their own domestic constituencies by increasing transparency and accountability in the use of both internal and external financial resources where possible establishing comprehensive and coherent budgets and medium-term expenditure plans.

It is also vital that the LDCs themselves regain donors' confidence and build the support of their own domestic constituencies by increasing transparency and accountability in the use of both internal and external financial resources where possible establishing comprehensive and coherent budgets and medium-term expenditure plans.

2. MAKING AID MORE EFFECTIVE

There is a need not simply for more aid, but also for more effective aid. Most research actually shows that foreign aid increases investment in recipient

Box 19. Recent contributions to the debate on aid effectiveness

There are many who doubt that aid can work in practice and who argue that empirical evidence shows that it does not work, or that it works only in countries that have undertaken the type of policy reforms advocated by the IMF and the World Bank. However, the weight of evidence does not support either of these contentions (see Beynon, 2001; Hermes and Lensink, 2001).

Econometric studies of aid effectiveness conducted up to the mid-1990s have been reviewed in Hansen and Tarp (2000). They find that:

- Aid increases aggregate savings, though not by as much as the aid flows.
- Aid generally increases investment.
- In all cases where growth is founded on the cumulative expansion of savings and investment, aid has positive effects on growth.

The majority of recent studies have also confirmed that foreign aid has a positive effect of aid on growth, and that this occurs through increasing physical and human capital accumulation. But no link has been found between aid inflows and growth in factor productivity (World Bank, 2001). One result which is particularly important for the LDCs suggests that, all other things being equal, aid is more effective in countries subject to high external and climatic shocks (Guillaumont and Chauvet, 2001). The result implies that aid may be particularly important in lessening the negative effects of high vulnerability. Recent research also shows that high levels of external debt can reduce the positive effects of aid inflows on growth and investment (Hansen, 2001).

Donors have been particularly influenced by econometric work which purportedly shows that aid has a positive impact on growth only if a certain type of national policy environment is present, one in which the economy is open and government intervention is limited (Burnside and Dollar, 1997, 2000). This work has provided the basis for some of the conclusions in the key World Bank report on aid (World Bank, 1998). The consequence is that aid is seen as helping poverty reduction best through strengthening the policy environment for poverty reduction. But close scrutiny of the Burnside and Dollar studies has shown that their findings are not econometrically robust (Hansen and Tarp, 2000, 2001; Dalgaard and Hansen, 2001). What is perhaps more important is that in recent work increasing attention is being given to the proposition that although the impact of aid on growth is generally positive, there are decreasing marginal returns to aid inflows owing to such factors as absorptive capacity constraints, institutional destruction caused by aid inflows, and negative effects on exchange rates. Given diminishing marginal returns, the question has arisen whether the effects of aid become negative, and if so, at what point. Estimates vary, but most have suggested that aid can have a negative impact on growth once it exceeds 25–50 per cent of GNP (Lensink and White, 2001). One would expect that where the turning point lies depends on the aid delivery system; and given a very uncoordinated aid delivery system in which multiple donors are pursuing their own agenda, it could be reached quite quickly.

It is certainly necessary to have a realistic view of how aid works in practice. Moreover, one must recognize a central dilemma of aid is that "Aid is likely to be most effective in countries which need it least, and least effective in countries that need it most" (Ehrenpreis, 2001). However, the ineffectiveness of aid has been exaggerated. The central policy issue is not whether aid works, but how to make it work better.

countries (see box 19). However, in the past aid was not yielding as much value for money as it could. The current conventional wisdom suggests that the major reason for this was that it was allocated to countries where the national policy environment was not right and national policies were weakly owned. However, this is a "one-eyed" explanation. Aid effectiveness depends on both aid recipients' policies and aid donors' policies. It is certainly true that the nature of aid recipients' policies affects aid effectiveness. However, the finding that it works only within open economies with limited government is not econometrically robust (see box 19). Increased selectivity, in which aid flows are focused on what are regarded as the right national policy environments, will not make aid work better unless there are also improvements in donors' policies. Moreover, if what are regarded as the right national policies are actually not those that are appropriate in countries in which there is generalized poverty, one should not expect that increased selectivity will increase aid effectiveness.

Aid effectiveness depends on both aid recipients' policies and aid donors' policies.

As argued in *The Least Developed Countries 2000 Report*, the process of structural adjustment in the 1980s and 1990s itself undermined aid effectiveness. In that period, relatively strong coordination of policy conditionality around IMF and World Bank structural adjustment programmes tied aid disbursements to what we have argued in the last chapter was an inappropriate policy model for national development and poverty reduction. At the same time, there was no mechanism for coordinating aid inflows and thus the aid delivery system was characterized by a multiplicity of fragmented aid-funded programmes and projects that generated high transaction costs for recipient countries and were weakly integrated into national economic and administrative structures. The combination of (i) the drive to reduce the budget deficit (excluding grants), (ii) interruptions of aid flows when fiscal targets were not met or other policy slippages occurred, (iii) rising debt service obligations and (iv) the proliferation of donor projects that were increasingly managed through parallel government structures, disrupted development processes and eroded State capacities (UNCTAD, 2000a: 175–192). One of the reasons why the introduction of the PRSP approach is so important is that it should enable greater coordination of aid inflows around a common objective and a common nationally defined strategy. The approach thus has much potential to increase aid effectiveness. However, as discussed in the last chapter, important changes in donor behaviour are required in order to achieve those gains, notably in policy conditionality and donor alignment behind national strategies. To achieve this, it would be helpful if practical experiences in building a genuine partnership through new institutional mechanisms for donor performance monitoring at the recipient country level, such as that which is evolving in the United Republic of Tanzania (see box 17, chapter 5), are generalized amongst the LDCs.

One of the reasons why the introduction of the PRSP approach is so important is that it should enable greater coordination of aid inflows around a common objective and a common nationally defined strategy. The approach thus has much potential to increase aid effectiveness.

Apart from conditionality, coordination and ownership issues which the PRSP approach is expected to deal with, there are four other important shifts in donor policies which are necessary for increased aid effectiveness. Firstly, it is necessary that the donor-driven aid/debt service system, which was outlined in chapter 4, be ended. In the 1990s, the donor community "was stuck in a dance of new rounds of transfers to finance debt service, avoid embarrassing arrears, and stave off growing risks of documented development failures" (Birdsall, Claessens and Diwan, 2001: 21). Aid will not effectively promote development until it is used for development purposes rather than as part of this "debt game". It is for this reason that increased and accelerated debt relief is so important, as the 'debt-tail' will not stop wagging the 'aid-dog' until there is a sustainable exit from the debt problem.

Aid effectiveness will be enhanced if aid is concentrated in major under-funded activities that can provide high developmental returns in terms of sustained growth and poverty reduction in the long run.

Secondly, donor countries must implement in an expeditious manner the OECD/DAC recommendation to untie aid to the LDCs, which was agreed in May 2001 and included as a commitment in the Programme of Action for the Least Developed Countries for the Decade 2001–2010. It has been estimated that the tying of aid to procurement from donor countries has reduced the value of aid by as much as 20–25 per cent. Increased international competition in procurement should increase aid effectiveness. However, it is unfortunate that both food aid and technical assistance were excluded from the agreement to untie aid, in the latter case because some donor countries believed that their own consultancy services sector was "too weak to face world competition" (*Financial Times*, 2001). The implications of these exclusions for aid effectiveness should be monitored.

Thirdly, aid effectiveness will be enhanced if aid is concentrated in major under-funded activities that can provide high developmental returns in terms of

Box 20. The MISA Initiative

In some Latin American countries, an innovative approach has been introduced to reduce poverty, to enhance the human capital of the poor and to combat child labour. The approach involves providing a minimum income to the poorest and most vulnerable families, conditional on regular school attendance by all their children of school-going age. It has been implemented in the Bolsa-Escola Programme in Brazil, and in a different form in the Progresa Programme in Mexico. As a deliverable for the Third United Nations Conference on the Least Developed Countries, the ILO and UNCTAD brought together an Advisory Group to prepare a report on the desirability and feasibility of applying this approach in African least developed countries.

The report argues that there is a strong justification for applying the Minimum Income for School Attendance (MISA) approach in African least developed countries in order to achieve both education and poverty reduction objectives. Direct private costs of school attendance for a sample of African LDCs are, on average, slightly more than twice the level of public recurrent expenditures per pupil in the 1990s. Moreover, households sending their children to school have to bear significant opportunity costs, in terms of the income forgone arising from the reduced availability of child labour. These can be estimated as about 35 per cent of average rural incomes and are generally more than twice the level of public recurrent expenditure per pupil in African LDCs. Poor households are not sending their children to school as they cannot meet these costs. Measures are required to reduce the costs of educating children incurred by poor households, so as to ensure that the benefits of the necessary supply-side policies to improve education reach the poor, and thus to achieve schooling for all. This is what MISA programmes do.

MISA programmes not only support the achievement of educational objectives, but also can make a major contribution to poverty reduction. They contribute to poverty reduction through: (i) the immediate poverty-alleviating effect on the household budget; (ii) the long-term effect on building up the assets of poor households in terms of human capital, which is important for both poverty reduction and growth enhancement; and (iii) the wider short-term poverty reduction effects of the cash transfer which occur through the direct effects of the income and security provided by the cash transfer, the multiplier effects of the cash injection on the local community, changes in the sense of citizenship of poor and excluded groups, increased social policy coordination and enhanced gender balance. The last effect occurs when mothers are the recipients of the cash transfers.

MISA programmes give poor and vulnerable households more room for manoeuvre in their livelihood strategies. They help to prevent households and communities from becoming enmeshed in clientelistic and paternalistic practices, strengthening their autonomy. The poor are usually excluded from formal credit and insurance markets and informal safety nets are imperfect, particularly in the face of common risks. Moreover, the poor can face labour market exclusion owing to malnutrition. In this situation, the MISA approach can enable household members to get out of counter-productive risk-management strategies which lock them into low-risk/low-return activities, diminish specialization and lower the degree of marketization of the economy.

In short, MISA programmes offer an approach to promote economic opportunity, to facilitate empowerment, and to enhance the security and dignity of poor households at one and the same time. As such, they provide a powerful and innovative approach which can be integrated within poverty reduction strategies to help achieve their goals.

The cost of implementing a MISA programme in an African LDC will depend on the design chosen and the scope. The ILO/UNCTAD report estimates that the total costs per country of a "bare-bones" programme, which merely seeks to close the gap between the gross enrolment rate and the net enrolment rate, are generally under $50 million a year.

Given present constraints on domestic financing, MISA programmes must largely be funded, at least in the initial stages, through international sources of finance. Debt relief offers one possible source, but the enhanced HIPC Initiative opens up insufficient fiscal space to provide a viable source of finance. Thus MISA programmes must largely be funded by international aid, probably through a multi-donor funding process. Aid has not traditionally been used to provide cash transfers to households. But the benefits are likely to be substantial and, as the Progresa experience in particular has shown, justify this kind of innovative approach to aid. International social funds to support Africa are currently being proposed and MISA programmes could fit logically within this framework.

As a follow-up to the ILO/UNCTAD report, and following the high level of interest expressed in the approach by the Government of Mozambique, work is under way to establish a pilot project in Mozambique. This is being supported by the Ford Foundation.

Source: ILO/UNCTAD (2001).

TABLE 46. EXTERNAL ASSISTANCE TO AGRICULTURE (EAA) IN LDCS, 1981–1999

Year	External assistance to agriculture (current $, million)	External assistance to agriculture (1998 $, million)[a]	Share of EAA in total ODA (%)
1981	2 173	3 890.8	21.1
1982	2 317	4 287.6	22.0
1983	2 214	4 124.4	21.5
1984	1 808	3 444.5	17.0
1985	2 228	4 211.7	20.5
1986	2 329	3 501.7	17.8
1987	2 845	3 696.7	17.9
1988	3 354	4 028.8	21.0
1989	2 826	3 477.0	18.2
1990	3 090	3 381.1	19.3
1991	1 881	1 981.7	10.7
1992	2 505	2 487.3	14.7
1993	1 708	1 724.6	11.0
1994	1 520	1 468.0	9.3
1995	1 798	1 586.8	11.5
1996	2 185	1 988.5	15.0
1997	2 205	2 161.6	15.7
1998	2 270	2 270.0	16.0
1999	2 145	2 105.6	14.3
Average 1981–1990	2 518	3 804.4	19.6
Average 1991–1999	2 014	1 974.9	13.1

Source: UNCTAD secretariat estimates based on FAO (2001).

a Real external assistance for agriculture is estimated using the DAC deflator.

sustained growth and poverty reduction in the long run. What this implies is using aid not simply to promote the establishment of policy frameworks that are expected to support poverty reduction, but also using it selectively within countries to finance essential missing ingredients for a sustained process of development and poverty reduction. Such selectivity within countries is particularly important if aid inflows increase, as there is otherwise a danger that there will be diminishing returns to aid. Major under-funded activities should be identified by Governments as part of their PRSPs. Investment in education and health are certainly important, and there is scope here for innovative approaches to aid that could have multiple beneficial effects (box 20). But aid should not be concerned only with social sectors on the ground that these are easily monitorable as being pro-poor. In the last two decades, there has been a tendency to focus aid to the LDCs increasingly on social sectors, and in the context of declining total aid flows this shift in priorities has implied that the allocation of aid to productive sectors and economic infrastructure has been neglected. These areas can provide important developmental returns. Indeed, they are fundamental to a long-term transition in which the growth process increasingly relies on exports, domestic savings and private capital inflows.

Investment in education and health are certainly important... But aid should not be concerned only with social sectors on the ground that these are easily monitorable as being pro-poor... The allocation of aid to productive sectors and economic infrastructure has been neglected.

A particularly stark example is that of agriculture, from which the majority of people in the LDCs earn their livelihood. In real terms external assistance to agriculture in the LDCs in the 1990s was half the level it was in the 1980s (table 46). However, there are major opportunities for productivity growth and poverty reduction through increased public investment in agricultural research and development, rural infrastructure and also agricultural extension, which requires official external finance. A Green Revolution in certain minor cereals and also cassava can play a key role in rural poverty reduction in many LDCs, and aid could effectively support this process (Mosley, 2000).

It is important, therefore, that donor and recipient countries explore possibilities for investment in production as well as in social sectors. Given past experience, it is likely to be important to focus on how aid can facilitate productivity growth as well as increased investment, and also export development. Major gains may also come from improvements in technical assistance, which absorbs an important part of aid flows, but which, evaluations suggests has not contributed much to building domestic capability (Arndt, 2000). Renewed attention also needs to be given to the way in which aid can facilitate the transfer of technology to the LDCs and can help finance enterprise development within them, as well as to the links between ODA and developmental FDI.

Finally, the effectiveness of aid can be increased if donors deliver it in a way which contributes to economic stability rather than acts as a source of shocks. Available evidence shows that foreign aid flows are both very variable and unpredictable for the LDCs. In the majority of cases for which data are available, annual variations in aid are actually higher than annual variations in export revenues, and fluctuations in aid inflows have served to reinforce, rather than dampen, external shocks (UNCTAD, 2000a: Part II, chapter 5). Comparisons of donor aid projections with donor aid disbursements also show that “aid cannot be reliably predicted on the basis of donors’ commitments” (Bulir and Hamann, 2001: 18) and that “the predictive power of donors’ commitments tends to be lower in poorer and in more aid-dependent countries” (ibid.: 12). Bulir and Hamann’s analysis of official projections of aid made by both national authorities and the IMF in ESAF-funded programmes in 37 countries, including 14 LDCs, shows that:

Renewed attention also needs to be given to the way in which aid can facilitate the transfer of technology to the LDCs and can help finance enterprise development within them, as well as to the links between ODA and developmental FDI.

- For project aid, and focusing on authorities’ projections at the time of budget presentation (which usually take updated commitments by donors at face value), the average errors in projections vis-à-vis disbursements is 15 per cent, which is equivalent to about 1.5 per cent of GDP. On average, disbursements were overestimated, but there were a fair number of cases in which aid disbursements were underestimated.
- For programme aid, and focusing on IMF-programme projections (the numbers used in IMF Board meeting documents, which are based on updated commitments of donors), the average errors between projections and disbursements vary between countries where programmes are interrupted owing to breaches of conditionality (which will necessarily lead to lower disbursements than projected) and those without interruption. There is, nevertheless, a general pattern in which projections overestimate aid actually received. Countries with programme interruptions received on average only about one third of programme aid commitments (equivalent to 3.3 per cent of GDP). But countries with uninterrupted programmes received only three quarters of programme aid commitments even though they remained officially on track. Disbursements exceeded IMF programme projections in only four out of 28 countries in all.
- The quarterly distribution of programme aid also falls considerably short of the programmed path. On average, actual quarterly out-turns deviate by about 50 per cent from the quarterly path estimated at the beginning of the programme period (i.e. if the country expected $10 million it receives on average either $5 million or $15 million), and out of 23 countries for which quarterly data are available, only two countries receive programme aid with prediction errors lower than 20 per cent.

In short, "official projections of aid (including those of the IMF) are subject to large errors and… particularly in the case of program aid, they seem to exhibit a substantial upward bias" (Bulir and Hamann, 2001: 28).

Given the importance of aid for investment and resource allocation in most LDCs, the unpredictability of aid can have major adverse consequences in reducing the effectiveness of aid in poverty reduction. More stable and more predictable aid inflows are therefore essential for increased aid effectiveness.

D. Market access and its effectiveness

At the same time as foreign aid has been declining, there have been increasing efforts to support the LDCs by providing them with preferential market access for their exports.

At the same time as foreign aid has been declining, there have been increasing efforts to support the LDCs by providing them with preferential market access for their exports. The need for specific market access advantages for developing countries was first noted more than three decades ago, at UNCTAD II in 1968, and special treatment for the LDCs has been provided by developed countries through the Generalized System of Preferences (GSP) schemes, and by developing countries through the Global System of Trade Preferences among Developing Countries (GSTP). In the Singapore Ministerial Declaration in 1996 WTO members agreed to take measures in favour of LDCs, "including provision for taking positive measures, for example, duty-free access on an autonomous basis, aiming at improving their overall capacity to respond to the opportunities offered by the trading system".

Following this Declaration, several WTO members provided details of existing or planned measures of enhanced market access for the LDCs at the High-level Meeting on Integrated Initiatives for LDCs' Trade Development in 1997. At an Ad Hoc Expert Group meeting, convened by the Secretary-General of UNCTAD in 1998, on GSP, GSTP and the new initiatives for LDCs, experts reported on new initiatives taken by a number of developing countries — India, Indonesia, Morocco, the Republic of Korea, South Africa, Thailand and Turkey — pursuant to their announcements at the High-level Meeting. In 1999, in the preparations for the Third WTO Ministerial Conference in Seattle, the European Union launched a proposal directed at "entering into a commitment to ensure duty-free market access not later than at the end of the new round of negotiations for essentially all products exported by the LDCs". In May 2000, a number of developed and developing countries announced further tariff preferences for the LDCs. The Quad countries (Canada, the EU, Japan and the United States), which import about three quarters of total LDC exports, also proposed to implement both tariff-free and quota-free treatment, "consistent with domestic requirements and international agreements", under their preferential schemes for "essentially all" products originating in the LDCs. Arguably, the "essentially all" qualification of the offer was designed to cover the respective concerns of the Quad countries in agriculture (the European Union), textiles and clothing (the United States and Canada) and fish (Japan). Moreover, the use of the word "consistent" with the existing requirements suggests that current rules of origin and administrative procedures will not be modified.

Most of the Quad countries have recently undertaken concrete action to provide more favourable market access conditions to LDCs and sub-Saharan African countries.

Most of the Quad countries have recently undertaken concrete action to provide more favourable market access conditions to LDCs and sub-Saharan African countries. In May 2000, the United States enacted the African Growth and Opportunity Act (AGOA), by which the basic United States GSP scheme was amended in favour of designated sub-Saharan African countries to include a larger range of products. In particular, preferential treatment was granted to

selected apparel articles subject to special provisions, rules of origin and customs requirements. In September 2000, the Canadian Government enlarged the product coverage of its GSP scheme to allow 570 products originating in LDCs to enter its market duty-free. On 5 March 2001, as a major deliverable prepared for the Third United Nations Conference on the Least Developed Countries, the "Everything but Arms" (EBA) proposal of the European Union Commission, granting unrestricted duty-free access to all LDCs products, excluding arms, was approved and entered into effect. The original proposal was amended to provide longer transition periods for the phasing-out of customs duties on three very sensitive products, namely bananas, rice and sugar. Following a review of the GSP scheme of Japan, conducted in December 2000, that scheme was revised and extended for 10 years until 31 March 2011. The revised scheme introduced, as of 1 April 2001, an additional list of industrial products originating in LDC beneficiaries that are granted duty- and quota-free entry.

In theory, preferential market access provided through these initiatives can enhance the competitive advantage of the LDC exporters and thus promote faster export growth in the LDCs... However, improved market access is commercially meaningless if the LDCs cannot produce in the sectors in which they have preferential treatment and lack the marketing skills, information and connections to convert market access into market entry.

In theory, preferential market access provided through these initiatives can enhance the competitive advantage of the LDC exporters and thus promote faster export growth in the LDCs.[8] However, in practice realizing this competitive advantage depends critically on supply capabilities. Improved market access is commercially meaningless if the LDCs cannot produce in the sectors in which they have preferential treatment and they lack the marketing skills, information and connections to convert market access into market entry. In assessing the potential effects of recent market access initiatives for growth and poverty reduction in the LDCs, it is also important to be cognizant of past experience with unilateral trade preferences. This shows that the mere granting of tariff preferences or duty-free market access to exports originating in LDCs does not ensure that the trade preferences can be effectively utilized by them. Indeed, available estimates suggest that in the late 1990s about half of LDC exports to Quad markets which were potentially eligible for GSP preferential treatment in reality did not (and still largely do not) qualify for the preferential tariff rates, thus causing unnecessary payment of most-favoured-nation (MFN) customs duties, rejected imports, unnecessary testing, spoilage, legal fees and forgone opportunities in general (UNCTAD, 2001a).

In 1999, 99 per cent of total imports into the EU from non-ACP LDCs were eligible for GSP treatment, but only 34 per cent of the imports eligible for preferential treatment actually received it.

The utilization ratio, defined as the ratio between total imports actually receiving preferences and the total imports eligible for preferences in any given market, was better for the United States (77 per cent), Japan (73 per cent) and Canada (59 per cent). But just 34 per cent of exports from non-ACP (African, Caribbean and Pacific) LDCs potentially eligible for GSP preferential treatment in the EU were receiving this treatment in 1999 (table 47). In effect, although the EU preferential scheme covered about 99 per cent of products, more than two thirds of non-ACP LDC exports (more than $2 billion) paid MFN duties rather than receiving the preferences. Data are unavailable for ACP LDCs, but there is no reason to assume that similar patterns did not prevail.[9]

It is also worth noting that relatively high utilization rates (for instance, in the case of the United States and Canada) do not guarantee that market access at preferential rates exists and has been effective. This holds particularly true where important sectors of interest to LDC exporters (processed food, garments and footwear, to mention just a few) may be excluded by a preferential arrangement. In this case, the lack of product coverage is the main problem affecting the value of trade preferences rather than the utilization of the few preferences available. It remains to be seen whether the recent initiatives expanding product coverage in new sectors will result in utilization rates higher than those recorded under other schemes traditionally providing preferences to those sectors.

TABLE 47. EFFECTIVE BENEFITS OF QUAD COUNTRIES' GENERALIZED SYSTEM OF PREFERENCES (GSP) FOR LDCS, LATE 1990S

	Imports from LDCs							
	Total imports *1*	Dutiable imports *2*	Covered by GSP scheme *3*	Receiving preferential treatment *4*	Total/ dutiable imports *(2/1)*	GSP-eligible/ dutiable imports *(3/2)*	Utilization rate *(4/3)*	Utility rate *(4/2)*
	$ millions				*Percentage*			
Canada[a]	256	92	10	6	36	11	59	6
EU[b]	3 562	3 101	3 075	1 035	87	99	34	33
Japan[c]	1 248	765	314	229	61	41	73	30
USA[a]	4 975	4 247	2 282	1 747	85	54	77	41
USA, excl. minerals	2 613	2 078	113	89	80	5	79	4
Total	10 041	8 205	5 681	3 017	82	69	53	37
Total, excl. USA minerals	7 679	6 036	3 512	1 359	79	58	39	23

Source: UNCTAD (2001a).
Note: EU excludes ACP LDCs and USA excludes Haiti, a beneficiary of the Caribbean Basin Initiative.
a 1998.
b 1999.
c 1997.

Utilization rates also vary amongst LDCs. In 1997, Bangladesh supplied more than half of the preferential exports of all LDCs to the EU, Norway and Canada, while Angola supplied the United States with more than 80 per cent of the latter's preferential imports from the LDCs. Mauritania and Bangladesh accounted for 75 per cent of total preferential imports from LDCs into Japan, while Nepal, Bangladesh and Sierra Leone supplied Switzerland with about 85 per cent of its preferential imports from LDCs (UNCTAD, 2001b: 8–9).

The reasons for the low and uneven levels of utilization of trade preferences include: the lack of security of market access, rules of origin, and lack of technical knowledge, human resources and institutional capacity.

The reasons for the low and uneven levels of utilization are various. They include: the lack of security of market access, which is due to the autonomous and unilateral character of the GSP; rules of origin which, amongst other things, restrict the use of imported materials and components and which are overly restrictive given the level of productive development in the LDCs; and lack of technical knowledge, human resources and institutional capacity to take advantage of preferential arrangements which require in-depth knowledge of national tariff systems in various preference-giving countries (UNCTAD, 2001a).

Non-tariff barriers also pose serious impediments to the realization of trading opportunities for LDCs. These barriers include quotas as well as technical and product standards, and sanitary and phytosanitary measures. Non-tariff barriers appear to be applied particularly to agricultural goods and textiles. It has been estimated that as regards LDC exports of agricultural and fishery products, 42 per cent of the product lines estimated at the HS 06-digit level face non-tariff barriers in Quad country markets, and that as regards LDC exports of textiles and clothing, 66–69 per cent of the product lines face non-tariff barriers in Quad country markets (Bacchetta and Bora, 2001: table 21). A particular problem is phytosanitary measures. Thirty per cent of LDC exports are affected by environment-related trade barriers, and the figure is particularly high for a number of Asian LDCs (Fontagne, Kirchbach and Mimouni, 2001).

Thirty per cent of LDC exports are affected by environment-related trade barriers.

The basic potential value-added of the recent initiatives to grant duty-free and quota-free market access to the LDCs lies in the enhancement of preference margins on tariff peak products (see table 48), and the expansion of product coverage, in addition to existing GSP and GSTP preferences. Amongst the Quad countries, expansion of product coverage would be particularly desirable in the

cases of Canada, Japan and the United States. It is estimated that in the later 1990s the percentage of dutiable exports excluded from preferences was as high as 90 per cent in Canada, 59 per cent in Japan and 47 per cent in the United States (95 per cent, excluding oils and minerals). Product coverage was much wider in the EU. For example, in 1997, before the "Everything but Arms" initiative, only 11 out of 502 items exported to the EU from all LDCs as a group with a value of more than $500,000 were not eligible for duty- and quota-free access (Stevens and Kennan, 2001).

TABLE 48. AVERAGE TARIFF RATES ON TARIFF PEAK PRODUCTS AND ALL GOODS IMPORTED BY QUAD COUNTRIES, 1999

(Average tariff rates, unweighted in percentage)

	Number of countries	All goods imports	Tariff peak products
Canada			
MFN rate		8.3	30.5
Preferential rate			
LDCs	47	4.4	22.8
GSP-only beneficiaries	108	6.2	28.2
Other preferential arrangements[a]			
Caribbean community	18	4.3	23.3
Australia	1	7.8	28.2
Chile	1	2.4	12.2
Israel	1	2.5	11.8
Mexico	1	3.1	15.9
New Zealand	1	7.8	28.2
USA	1	1.6	7.1
EU			
MFN rate		7.4	40.3
Preferential rates			
ACP LDCs	37	0.8	11.9
Non-ACP LDCs	11	0.9	12.6
GSP-only beneficiaries	42	3.6	19.8
Other preferential arrangements[a]			
Non-LDC ACP countries	32	0.9	12.4
Eastern Europe and Middle East	30	1.8	20.1
Japan			
MFN rate		4.3	27.8
Preferential rate			
LDCs	42	1.7	19.0
GSP-only beneficiaries	127	2.3	22.7
USA			
MFN rate		5.0	20.8
Preferential rate			
LDCs	38	1.8	14.4
GSP-only beneficiaries	80	2.4	16.0
Other preferential arrangements[a]			
Caribbean community	22	1.6	13.5
ANDEAN	4	1.7	14.0
Canada	1	0.1	0.6
Israel	1	0.1	0.6
Mexico	1	0.3	1.6

Source: Hoekman, Ng and Olarreaga (2001: table 3), reproduced in IMF/World Bank (2001b).

Note: Tariff peak products are products facing import tariffs of 15 per cent or more. In 1996–1998, as a percentage of total imports from LDCs, such products constituted: Canada, 30.2%; EU, 2.8%; Japan, 2.1%; and USA, 15%.

a For a detailed explanation of the sample compositions in the different country groups, see Hoekman, Ng and Olarreaga (2001: 11, footnote to table 3).

It has been estimated that if the EU initiative were extended and all Quad members were to grant duty-free access for tariff peak products (products with tariff rate of over 15 per cent), LDC exports would increase by 11 per cent (Hoekman, Ng and Olarreaga, 2001).[10] However, gains are concentrated in only a few countries, particularly exporters of manufactures. Bangladesh is the major beneficiary in absolute terms, accounting for 60 per cent of the total increase in LDC exports which would follow from duty-free access of tariff-peak products to the Canadian market, 47 per cent of the total increase in LDC exports which would follow from duty-free access to the Japanese market, and 67 per cent of the total increase which would follow from duty-free access to the United States market. Other countries exporting manufactures would also benefit significantly in relative terms, with Cambodia, Haiti and the Lao People's Democratic Republic, as well as Cape Verde and Maldives, all expected to witness an increase in exports of more than 20 per cent, and Madagascar, Myanmar and Nepal also seeing gains. The exports of three primary commodity exporters — Liberia, Malawi and Somalia — are expected to increase by 20 per cent or more, and other countries expected to see relatively important export increases are Gambia, Kiribati, Sudan and Togo.

Actual gains may well be smaller than these simulated estimates. The other major study of the impact of duty- and quota-free market access for LDCs to Quad countries suggests that LDC exports will not increase by 11 per cent, but rather by just 3 per cent (UNCTAD/Commonwealth Secretariat, 2001). Moreover, both simulations, as they themselves stress, ignore the problem of low utilization rates, as well as the weak export capacity and supply constraints, which mean that the effective benefits are lower than those simulated.

LDC Governments should strengthen the productivity and competitiveness of activities which are of strategic importance to trade and development.

It is certainly desirable that developed countries that have not already done so work towards the objective of duty-free and quota-free access for all least developed countries' exports, as envisaged in the Programme of Action for the Least Developed Countries for the Decade 2001–2010 adopted in Brussels. But various measures are also required in order to improve the effectiveness of trade preferences for the LDCs in the context of recent proposals for duty-free and quota-free market access. These are:

- An increase in the stability and predictability of trade preferences through a set of multilaterally agreed criteria to be adhered to by all preference-giving countries in the operation of their preferential schemes (see box 21);
- Expansion of product coverage to include excluded products;
- Development of a harmonized and updated set of rules of origin to be applied in the context of the initiative for duty-free and quota-free market access in favour of the LDCs, taking into account the industrial reality of those countries;
- Technical assistance activities aimed at providing information services and training courses to local producers and exporters, strengthening human resources and institutional capacities to comply with administrative and customs procedures under different GSP schemes and preferential arrangements, and establishing a network of cooperating institutions. UNCTAD has particular expertise in this area.

In the end, the ultimate constraint on realizing the benefits of trade preferences is weak supply capabilities. In this regard, increased aid flows to promote exports, investment and increased domestic resource mobilization remain essential, as well as the national policy autonomy to enable LDC

Box 21. Binding trade preferences for LDCs

Binding trade preferences is one mechanism that can be used to increase the commercial benefits of trade preferences for LDCs. Such binding would enhance the benefits of new initiatives to provide quota- and duty-free access for LDCs by increasing their predictability and increasing the security of preferential market access.

Binding trade preferences could be ensured through the negotiation of a new multilateral (WTO) legal instrument, (a) imparting stability and predictability to the duty-free treatment granted to LDCs, while (b) ensuring the maximum contractual security of preferences since any temporary withdrawal of duty-free treatment would be subject to the disciplines of the relevant WTO Agreements, and (c) harmonizing and matching rules-of-origin requirements with the actual industrial capacity of LDCs to increase utilization of trade preferences.

A WTO-compatible instrument might also include other aspects of market access, beyond tariff and origin, by making reference to other specific proposals on market access made by LDCs in recent years, for example with respect to S&D provisions.

The issue of "binding" was raised by the LDCs in the preparations for the Seattle Ministerial Conference in 1999. The Programme of Action for the Least Developed Countries for the Decade 2001–2010, in its paragraph 68(h), contains a commitment that "improvements in market access for LDCs should be granted on a secure and predictable basis". The LDCs' Ministerial Declaration of Zanzibar (July 2002) called upon the fourth WTO Ministerial Conference to agree on: "A binding commitment on duty free and quota free market access for all products from LDCs on a secure, long term and predictable basis with realistic and flexible Rules of Origin to match the industrial capacity of the LDCs" (para. 4). The outcome of the Doha WTO Ministerial Conference, however, did not reflect this proposal in that in the final Declaration, where Ministers committed themselves to working towards the objective of quota- and duty-free market access as well as to considering additional measures for progressive improvements in market access for LDCs (para. 42), the word "binding" was again omitted from the text. This is reflected in the current WTO work programme on market access for the LDCs, as adopted by the Sub-Committee on Least Developed Countries on 12 February 2002. In the wording of this work programme, however, the "examination of possible additional measures for progressive and predictable improvements in market access…and further improvement of the preferential access schemes such as the GSP schemes" (para. 7) might still leave some room for consideration of the issue of binding preferences. Furthermore, in the Doha Declaration Ministers "reaffirm the commitments we undertook at LDC III and agree that the WTO should take into account in designing its work programme for LDCs, the trade related elements of the Brussels Declaration and Programme of Action".

The single undertaking to emerge from the Doha Development Round should contain a contractual instrument providing "binding" status for duty-free access to LDCs, accompanied by supportive provisions on rules of origin and other matters of relevance to effective access market and utilization of these preferences. Without secure access and the assurance that duty-free access will actually be achieved, the possibility of attracting the necessary investment to meet the supply-side problems would seem rather slim for most LDCs.

Governments to strengthen the productivity and competitiveness of activities which are of strategic importance to trade and development.[11]

E. The Integrated Framework to support LDCs in their trade and trade-related activities

One recent initiative which is an opportunity to improve supply capabilities is the Integrated Framework for Trade-related Technical Assistance (IF). The basic objective of the IF, which was introduced in 1997, was to increase the benefits from trade-related technical assistance being provided by six core agencies,[12] by ensuring that trade-related technical assistance was demand-driven, that it matched the specific needs of each LDC, and that it enhanced rather than undermined each LDC's ownership of trade-related technical assistance. Trade-related technical assistance activities were broadly defined as:

- Establishing institutions to handle trade policy issues;
- Strengthening export supply capabilities;

- Strengthening trade support services;
- Strengthening trade facilitation capabilities;
- Training and human resource development for these four areas;
- Assistance in the creation of a supportive trade-related regulatory and policy framework that will encourage trade and investment.

The introduction of the IF was a response to the Uruguay Round Decision on Measures in Favour of Least Developed Countries, which called for "substantially increased technical assistance in the development, strengthening and diversification of their production and export bases including those of services, as well as in trade promotion, to enable them to maximize the benefits from liberalized access to markets" (GATT secretariat, 1994: 441). In the initial phase of the implementation of the IF, 40 LDCs were able to specify their needs for technical assistance, and 37 designated national focal points to coordinate IF implementation. But round-table meetings with potential donor countries were held only in Bangladesh, Gambia, Haiti, Uganda and the United Republic of Tanzania, and modest resources were generated only in the case of Uganda. From the LDCs' point of view, these outcomes fell far short of expectations.

The central focus of the pilot scheme is what is called "trade mainstreaming", a process which is designed to ensure that trade policy, trade-related technical assistance and capacity-building needs are articulated in a broad development context.

An evaluation of this phase of the IF concluded that the main reason for the poor performance was that trade-related proposals were not mainstreamed into the broader development strategy of a country. New arrangements for enhancing the implementation of the IF were thus proposed and it was agreed to implement the new approach on a pilot basis — the IF Pilot Scheme (PS) — in three PS countries (Cambodia, Madagascar and Mauritania), the Governments of which all demonstrated a strong interest in integrating trade priorities into their national development strategies, and a strong commitment to do so. The central focus of the pilot scheme is what is called "trade mainstreaming", a process which is designed to ensure that trade policy, trade-related technical assistance and capacity-building needs are articulated in a broad development context. For this purpose, "trade integration studies" are being carried out on a country-by-country basis. The studies, which are led by the World Bank, are intended to provide the basis for identification of trade priorities and needs for trade-related capacity building which are to be incorporated into individual least developed countries' development plans and strategies expressed through the PRSPs. This will occur through consideration of the findings and recommendations of the studies in national trade integration strategy workshops/PRSP Committees, which involve all stakeholders. Agencies will indicate their role in responding to these needs and how to meet them, and trade priorities identified in the studies will be presented to World Bank Consultative Group Meetings or UNDP Round Tables, as the case may be, for bilateral donor financing.[13]

Integration studies must see integration as a means to beneficial development and poverty reduction rather than as an end in itself.

The pilot scheme is still evolving, and individual country studies will no doubt produce various results. However, the comparative analysis of the relationship between poverty, trade and development in earlier chapters of this Report provides some important general insights that can help to improve the IF process as it advances. Our analysis underlines the importance of integrating trade into PRSPs, and also the wisdom of the judgement that this should be done through an examination of how trade can fit into the overall national development strategy. But it indicates strongly that integration studies must see integration as a means to beneficial development and poverty reduction rather than as an end in itself. It should not be assumed from the outset that the goal is to strengthen the policy environment for trade liberalization; rather, the objective should be to promote trade in a way which supports development and poverty reduction.

The principle of ownership, which has underpinned the IF from the outset, needs to be fully respected. This will require great sensitivity, since the capacity to undertake strategic analysis of trade issues is, by definition, limited. This is particularly important because when trade policy conclusions are mainstreamed into PRSPs, they will become the basis for policy conditionalities whose fulfilment will be required in order to ensure access to concessional assistance of all kinds, not simply access to trade-related technical assistance. If the principle of ownership is not respected, a process which was originally envisaged for the purpose of meeting the special needs of the LDCs will be transformed into an obligation which reduces the policy autonomy of the LDCs in the interests of other agendas. Ideally, the trade integration studies will themselves be a process through which national capacities are strengthened.

For the IF to make a significant contribution, the IF must now move speedily to implementing concrete capacity-building projects which bring tangible benefits for the LDCs.

Donor countries may face particularly difficult choices in financing trade-related technical assistance. One reason is that, relative to the usual development budgets of the LDCs, the costs of fully implementing WTO obligations are very high. It has been estimated, for example, that the average costs per country of implementing Uruguay Round commitments regarding customs valuation, sanitary and phytosanitary standards and intellectual property rights were $130 million in the late 1990s, which was more than the annual central government capital expenditure budget in seven out of 12 LDCs, and more than the annual gross domestic fixed capital in three of them (Finger and Schuler, 2000). As the IF process advances, it will be important that donors ensure an appropriate balance between different aspects of trade-related technical assistance which deserve attention, as they are put forward by the strategy workshops.

Finally, after five years of existence, the IF must now move speedily to implementing concrete capacity-building projects which bring tangible benefits for the LDCs. For the IF to make a significant contribution to the LDCs' capacity-building challenge, there must be a serious commitment to follow up on studies and workshops by donors and agencies, and to support the development of export supply capabilities through financial assistance as well as technical assistance.

F. International commodity policy

Improved market access is a necessary but not a sufficient condition for making international trade a tool for development. Given the overwhelming importance of primary commodities for the economies of many LDCs, and also the relationship between primary commodity dependence and extreme poverty, a review and recasting of international commodity policy are also of paramount importance.

A review and recasting of international commodity policy are of paramount importance.

For more than a decade after 1974, price-stabilizing international commodity agreements were the focus of international commodity policy. The success of this approach has been mixed at best, and its revival appears unlikely. The need to address the specific problems faced by commodity-exporting countries, however, is evident. This section attempts to provide some ideas about a framework for concerted and cooperative action by primary commodity exporters and importers that would aim to enhance the potential of commodity production and exports as a basis for development and poverty reduction, particularly for the LDCs. This framework for international commodity policy covers actions complementary to WTO negotiations, including in particular

negotiations on the subsidies to agriculture in OECD countries, whose reduction is of paramount importance for increasing agricultural exports by developing countries.

In order to promote development and poverty reduction in producing countries, an international commodity policy must address three issues. The first is the availability in producing countries of exportable products in sufficient volumes that would interest buyers and that meet the consumers' increasingly stringent requirements. Second, exporting countries need to enter supply chains for these products at points where higher degrees of value added are generated. The third issue is world primary commodity prices. Excessive instability in primary commodity prices, at least its negative impacts, needs to be mitigated and the problem of a continual downward trend of these prices must be addressed.

The first two of these issues can be considered primarily the responsibility of the LDCs themselves. But international support in these areas is an indispensable aspect of international commodity policy. With regard to the third issue, international cooperation is indispensable, including for the application of market-based price risk management instruments within producing countries.

The implementation of international commodity policy requires cooperation and, where possible, coordination between three pillars, namely international organizations within the UN system, providers of bilateral assistance and NGOs, and international commodity bodies (ICBs), as well as the Common Fund for Commodities (CFC). Each of these has a particular role to play in addressing the three issues mentioned above, based on expertise and comparative advantage. Cooperation and coordination are indispensable in order to generate synergies, prevent duplication or contradiction, and to place the actions in a global developmental perspective so as to avoid or mitigate undesirable impacts on vulnerable countries and producers. The provision of reliable information and analysis is also crucial for the success of international commodity policy.

At the present time, there is a disconnection between the accumulated knowledge about how to enhance supply capabilities in commodity-dependent countries and the activities of the IF.

Regarding the first issue, namely enhancing supply capacities through improved availability of exportable products in sufficient volumes that would interest buyers and that meet the consumers' increasingly stringent requirements, technical assistance needs to be provided by international organizations in their respective areas of competence and by ICBs for their specific commodities. Priority should be given to countries with the greatest need for such assistance, and in this regard LDCs that are highly dependent on a single primary commodity for their export earnings and in which there is generalized poverty merit close attention. Financing can be mobilized by increasing the resources available through the CFC or directly through the relevant international organizations. It is clear that the Integrated Framework can have a role to play. But at the present time, there is a disconnection between the accumulated knowledge about how to enhance supply capabilities in commodity-dependent countries and the activities of the IF. In areas such as research and development, quality control and assurance, a subregional approach may be adopted. Regarding the question of the availability of quantities sufficient to interest important buyers, organizational arrangements within countries appear to be crucial and NGOs working in the field, in conjunction with local producers' groupings, seem best placed to provide effective assistance. Given the abundance of supplies in world markets of many commodities of interest to LDCs, improvement of supply capacities should be interpreted to mean provision of better-quality and higher-valued products,

possibly in their processed forms, rather than an outright increase in the quantities put on world markets.

The new approach to international commodity policy must include measures that would enable developing countries, in particular LDCs, to participate more fully at higher value-added stages of the supply chain.

As argued in chapter 4, the changing structure of world commodity markets (with liberalization in developing exporting countries and, on the buyers' side, increasing concentration and the importance of supermarket chains) requires developing country Governments and entrepreneurs to have much greater business skills than before. The new structure of supply chains leads to the generation of increasingly high proportions of value added at the marketing and distribution stages. The new approach to international commodity policy must include measures that would enable developing countries, in particular LDCs, to participate more fully at these stages of the supply chain. Research by international organizations, in cooperation with ICBs, is required in order to understand better the structure of supply chains, identify the specific stages of high-value-added generation and assess the potential for exporting countries to enter these activities. This would also include the identification of constraints that may be eliminated through negotiations or overcome by technical and financial assistance and those that may be impossible to deal with in the current context. This identification would then lead to concerted action by the organizations and Governments concerned, and in cooperation with large transnationals where possible, to assist exporters through financial, technical and managerial assistance in their attempts to capture a higher proportion of the value added of the final products.

Mitigating excessive instability in world primary commodity prices, at least its negative impacts, and dealing with the problem of the continual downward trend of these prices also require concerted action

Mitigating excessive instability in world primary commodity prices, at least its negative impacts, and dealing with the problem of the continual downward trend of these prices also require concerted action by ICBs and international organizations, supported by governmental policies. Past efforts to mitigate excessive instability through economic measures in international commodity agreements (ICAs) have been successful only for limited periods of time. In view of this mixed record and the current lack of political will to implement such economic measures, their reintroduction into ICAs appears unlikely. One possible approach in this respect seems to be the promotion of arrangements between buyers and sellers that are based on longer-term commitments rather than on daily dealings. All parties must accept, however, that attaining some degree of stability may mean forgoing short-term gains. The introduction of at least some aspects of "fair trade" principles into mainstream trade may be an avenue to explore in this connection. For this to happen, incentives need to be provided by Governments and there needs to be cooperation between the NGO community and large business concerns. A joint UNCTAD/International Development Research Centre project is exploring modalities in this regard, with an initial focus on coffee. Some firms, such as Starbucks, have already decided to procure part of their supplies under "fair trade" arrangements, and the marketing of Max Havelaar products through the Migros supermarket chain in Switzerland has been a determining factor in achieving significant market shares, notably in bananas.

Since instability is inherent in commodity markets, price risk management instruments are a way to limit the incidence of instability for producers and traders. But for risk management instruments to be used successfully in the LDCs, innovative organizational forms will be needed to reach small farmers. A considerable investment in training will also be required and there is a need to establish the requisite institutional and legal frameworks. Ongoing application of these instruments in some LDCs is likely to reveal both the problems and the potential of this approach.

Compensatory financing is another means of mitigating some of the negative impacts of instability in prices and earnings. The international community, in discussing a new developmental approach to international commodity policy, must reconsider the use of compensatory financing for export earnings shortfalls. This is particularly important as an aspect of addressing what the new Programme of Action for the Least Developed Countries calls the "structural causes of indebtedness" (United Nations, 2001a, para. 86). The IMF contingency credit line is not available to a country which is borrowing from any other IMF facility and the IMF Compensatory Financing Facility (CFF) is so expensive that it would breach the concessional borrowing ceilings which are standard in Poverty Reduction Growth Facility (PRGF) programmes (Martin, 2001). The EU's "B envelope" funding, designed in part to replace its STABEX and SYSMIN export shortfall compensation windows, is more flexible. It introduces contingency financing for export and budget shortfalls, based on indices of vulnerability to economic and climatic shocks. Unfortunately, the terms governing access to this finance are very restrictive, requiring shocks which are equivalent to a 10 per cent drop in export earnings as well as a 10 per cent worsening of the budget deficit (ibid.). The design of appropriate contingency financing facilities for LDCs and other low-income countries is urgent. Also, donors can seek to ensure that the volume of aid inflows is anti-cyclical, and does not reinforce the effects of a sudden decline in the prices of key commodity exports.

The international community, in discussing a new developmental approach to international commodity policy, must reconsider the use of compensatory financing for export earnings shortfalls.

There is increasing recognition that there has been a long-term decline in world primary commodity prices. The reasons are disputed, but they include improvements in yields and productivity, the benefits of which have largely accrued to buyers, and the entry of new producers into primary commodity markets. It would naturally be unreasonable to suggest that productivity improvements be limited. The elements of international commodity policy mentioned above, however, could help producers in capturing more of the benefits of such improvements. The entry of new producers into already crowded markets is a more contentious issue. Increases in supplies in one country can result in a decline in prices that may have significant negative effects on other producers. International commodity policy should include modalities whereby regular consultations among international organizations, ICBs and Governments, as well as improved transparency, would help in directing efforts to increase production away from crowded markets to more dynamic products. In this connection, support is needed to assist high-cost producers in overcoming exit barriers that may prevent them from reacting rationally to declining prices, and to help those producers for whom the exit barriers cannot be eliminated. International commodity policy should also consider mechanisms for voluntary supply management schemes. In considering such mechanisms it is necessary to evaluate carefully the different objectives (elimination of accumulated stocks and reduction of production) and different instances of supply control (discouragement of new entrants, of increased production or of exports, and encouraging exit from production), as well as what is expected of consumers. In relation to declining prices, international commodity policy must also accord sufficient importance to increasing consumption of commodities, both through generic promotion and through new and innovative uses.

One key to the future behaviour of the international commodity economy is the position of more advanced developing countries. If they are able to move up the ladder of development, it will be much easier for the less developed developing countries, including the LDCs, to expand commodity exports without saturating markets.

One key to the future behaviour of the international commodity economy is the position of more advanced developing countries. If they are able to move up the ladder of development and export increasingly sophisticated manufacturing products, it will be much easier for the less developed developing countries, including the LDCs, to expand commodity exports without saturating markets.

Accelerated growth in middle-income countries will also ultimately be an important source of increased demand for primary commodities.

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Finally, the opportunity of using the WTO negotiations in support of the design and implementation of international commodity policy, and diversification efforts of commodity-dependent countries should be seriously considered. In this respect, it is noteworthy that small island developing States and a group of "single commodity exporters" have made proposals in the WTO in the context of the negotiations relating to the Agreement on Agriculture.

G. South–South cooperation and the problem of polarization

South–South cooperation including the encouragement of regional trade and investment dynamics, can be an important element in the development of new export capacities in the LDCs.

Another area of international policies for effective poverty reduction in the LDCs is enhanced South–South cooperation. This is generally a neglected part of analyses of how to reduce poverty in poor countries, and has not yet been adequately addressed in the PRSP approach. However, it is an essential part of the multi-level approach to poverty reduction which is being advocated here. Moreover, the Programme of Action for the Least Developed Countries for the Decade 2001–2010 recognized that it could play an important role in the development of the LDCs, and encouraged the use of "triangular mechanisms", through which "successful South–South cooperation may be attained using financial contributions from one or more donors, and taking advantage of economic complementarities among developing countries" (United Nations, 2001a, para. 19).

It is important that South–South cooperation be a complement to, and not a substitute for, North–South cooperation.

Possible areas for South–South cooperation noted in the Programme of Action include the encouragement of regional trade and investment dynamics, which, as is evident in this Report, can be an important element in the development of new export capacities in the LDCs, as well as technical assistance and exchange of best practices in a range of areas (such as the MISA Initiative). A number of LDCs are landlocked or transit countries, and for these countries a regional approach to transport infrastructure financing and to the development and management of transit systems is likely to be a particularly important aspect of the building of a dynamic investment–export nexus (UNCTAD, 1999b). Within sub-Saharan Africa, the corridor development approach, pioneered in the Southern African Development Community, is likely to be particularly promising. This seeks to concentrate viable productive investment projects within selected corridors connecting inland production areas to ports at the same time as infrastructure investment takes place. The synchronous development of directly productive activity and infrastructure ensures a revenue stream which renders the infrastructure investment attractive to private business. At the same time, infrastructure investments attract economic activity and help to promote the agglomeration process. Government policy aims to attract "anchor investments" which ensure the basic viability of infrastructure, and then to seek to attract other investment, a process called "densification". Performance-related incentives are geared towards encouraging domestic and foreign investment in internationally competitive and labour-absorbing projects, and are targeted to specific locations. They include tax holidays, grants to small and medium-sized enterprises, and grants to foreign investors to reimburse costs of shipping machinery and equipment to the corridor. Firms can also avail themselves of accelerated depreciation allowances, schemes to help manufacturers facing tariff reduction to modernize their plant and equipment, low interest schemes, support for basic research and

development, and venture capital finance. Special attention is paid to small and medium-sized enterprises.

It is important that South–South cooperation be a complement to, and not a substitute for, North–South cooperation. It is also important that enhanced South–South cooperation takes place in a context in which the various asymmetries in the international system that are making it difficult for the more advanced developing countries to deepen industrialization and move up the technological ladder are addressed. It will be difficult for the LDCs to get on and move up the ladder of development if the more advanced developing countries face a "glass ceiling" which blocks their development. Policies to counter the increasing polarization in the global economy are thus also necessary for poverty reduction in the LDCs.

H. Conclusion

In countries where there is generalized poverty, poverty reduction requires effective national policies which promote sustained growth and development. Through the PRSP process and related initiatives, Governments in LDCs are taking responsibility for poverty reduction within their national territories. However, success cannot be ensured unless sufficient resources are provided so that Governments committed to achieve the goal of poverty reduction and sustained development are not thwarted owing to lack of resources. It is also essential that national policy autonomy goes hand in hand with national responsibility.

In countries where there is generalized poverty, poverty reduction requires effective national policies which promote sustained growth and development. However, success cannot be ensured unless sufficient resources are provided so that Governments committed to achieve the goal of poverty reduction and sustained development are not thwarted owing to lack of resources. It is also essential that national policy autonomy goes hand in hand with national responsibility.

Drawing from the array of measures listed in the Programme of Action for the Least Developed Countries for the Decade 2001–2010, this chapter has identified important elements that should be part of a supportive international environment for poverty reduction in LDCs. These elements follow from the analysis of the nature and dynamics of poverty in the LDCs, and in particular the cause-and-effect relationship, which cause generalized poverty to persist. They are not stand-alone policies, but rather should be keyed into domestic policies designed to promote private investment, increased domestic resource mobilization and increased exports, and designed to ensure that, as economic growth takes place, specific groups and regions within countries are not left behind and marginalized.

The analysis confirms the importance of a number of the directions of the Programme of Action, in particular the need substantially to increase aid flows to the LDCs by implementing donor commitments and the need for more effective aid. More stable and predictable aid inflows are essential for increased aid effectiveness. Donor countries must implement in an expeditious manner the OECD/DAC recommendations to untie aid to the LDCs, which were included as a comment in the Programme of Action. Aid effectiveness will also be enhanced if productive sectors, notable agriculture, and economic infrastructure, which both have been relatively neglected in the context of declining total aid flows, receive greater attention.

Improving market access for the LDCs is shown to be not simply a matter of providing quota- and duty-free access, but also of making trade preferences commercially meaningful for exporters in the LDCs. Trade preferences should also not be seen as a substitute for aid inflows when supply capacities are weak. The Integrated Framework (IF) can help if trade-related technical assistance

activities are broadly defined and focused on strengthening export supply capacities, if the principle of ownership is fully respected in the mainstreaming of trade issues into PRSPs, and if financial assistance and technical assistance are provided to increase supply capabilities. The disconnect between the IF and the accumulated knowledge on upgrading primary commodity exports, also needs to be speedily bridged.

The analysis identifies increased and accelerated debt relief as an important requirement for effective poverty reduction in many LDCs. The debt issue has received much less international attention recently as non-governmental organizations have shifted their attention to trade issues. However, an unsustainable debt burden is still central to the international poverty trap in which many LDCs are caught. The Programme of Action does not go far enough in this area, though it must be said that the over-optimism of expectations of a sustainable exit from the debt problem has become clearer and clearer with the passing of time.

In the end, addressing the socio-economic marginalization of the LDCs will require addressing the polarization in the global economy.

The analysis also shows that much more attention should be given by the international community to two areas within the Programme of Action that are currently under-emphasized in the international support for poverty reduction, namely, international primary commodity policy and South–South cooperation. The former is the most glaring missing link in the current approach to poverty reduction, as the incidence of extreme poverty is closely related to primary commodity dependence. The latter is important because regional trade and investment linkages, as well as learning based on more successful development experiences, offer an important strand for effective development within the LDCs.

South–South cooperation needs to be developed within the context of the creation of a more supportive global environment that reduces the polarization of the global economy and the marginalization of the poorest countries at the same time. In the end, addressing the socio-economic marginalization of the LDCs will require addressing the polarization in the global economy. Gains from differentiated treatment will be particularly strong for LDCs if an approach is adopted which enables all developing countries to advance. Indeed, this may very well be essential in order to prevent more developing countries from slipping into the LDC category.

Notes

1. These are UNCTAD secretariat estimates based on IMF/IDA (2002a).
2. The eleven countries are: Burundi, the Central African Republic, Comoros, the Democratic Republic of the Congo, the Lao People's Democratic Republic, Liberia, Myanmar, Sierra Leone, Somalia, Sudan and Togo. The external debts of Angola and Yemen are considered sustainable without HIPC assistance.
3. For country case studies of what is happening on the ground in Mali, Ethiopia and Uganda, and an empirical evaluation of the adequacy of the HIPC Initiative, see Serieux and Samy (2001). For latest IMF/IDA views on the issue of long-term external debt sustainability, see IMF/IDA (2002a).
4. These are UNCTAD secretariat estimates based on OECD/DAC Statistical Reporting System, on-line databases. The percentage change of net ODA per capita in real terms (1999 $) is weighted by the population.
5. The Zedillo Report (United Nations, 2001b), prepared for the International Conference on Financing for Development in Monterrey, has estimated that meeting all the International Development Goals will require an extra $50 billion a year of ODA, almost double what is currently provided.
6. For precise definition of the options open to donors in terms of their aid commitments, see Part One, chapter 2, section F.
7. In particular, the United States announced that it would increase its bilateral development assistance by more, and more rapidly, than the increase originally announced, and would seek to initiate an increase in aid in the next 12 months, and that aid would be doubled, reaching an increase of $5 billion in the third year. The EU announced that it had agreed to increase its development aid to 0.39 per cent of GNI by 2006 as a first step towards the 0.7 per cent target. Japan promised an increase in aid as soon as domestic conditions improved.
8. For a general discussion of how tariff barriers in rich countries affect poverty, see World Bank (2002).
9. Both the EU's GSP scheme and the EU–ACP arrangement have similar requirements and a similar basic structure in terms of tariff preferences.
10. If all Quad members were to grant duty-free access for tariff peak products to both LDCs and other developing countries, it is estimated that LDC exports will increase by 6 per cent. This estimate does not include the possibility of increased exports from LDCs to other developing countries, which could arise because of the trade expansion in other developing countries which would follow their improved access to developed country markets. Unfortunately, no research has yet been undertaken on how LDCs might benefit from market access concessions from developed countries for all developing countries (LDCs and other developing countries), coupled with improved access for LDCs to developing country markets through regional integration arrangements.
11. The importance of national policy autonomy and the development of supply capabilities is emphasized in UNCTAD (1999a). Significantly, one study of the impact of improved market access in Quad countries on 37 sub-Saharan African countries finds that if total factor productivity increased by 1.5 per cent, gains in welfare would be comparable to the gains from completely unrestricted market access (Ianchovichina, Mattoo and Olarreaga, 2000).
12. The six core agencies are the IMF, ITC, UNCTAD, UNDP, World Bank and WTO.
13. An IF Trust Fund, managed by UNDP on behalf of the six core agencies, has been established to finance the "mainstreaming process". As of February 2002, 18 donors had made pledges to the Trust Fund totalling approximately $9.1 million. The overall process is guided by the IF Steering Committee (IFSC) and the Inter-agency Working Group (IAWG). The IFSC has a tripartite structure comprising donors, LDC representatives and representatives of the core agencies. Its functions are policy guidance and oversight, coordination, monitoring and assessment of IF progress. The IAWG's functions are exchange of information, coordination of events, preparation of the work programme and budget, and sequencing of activities.

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