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Trade and Poverty:

A Developmental Perspective

Issues Note by the UNCTAD secretariat

Executive Summary

The argument that trade and trade policies have a huge impact on economic outcomes, including poverty reduction, has been at the centre of controversy as the current wave of globalization has proceeded. While many economists and the international financial institutions argue that free trade and open capital markets are the key to economic success and poverty reduction, other economists, many non-governmental organizations, and the alter-globalization movements argue that, if not linked to broader social objectives, trade and financial liberalization can create inequality and poverty. Since neither side advocates autarky, the argument is over how to use the opportunities offered by globalization: the orthodox approach advocates free trade, capital mobility and, more recently, a host of other policies mainly designed to improve institutional quality, while others favour a more structured or managed integration.

But the links between trade and poverty are in practice neither simple nor automatic. UNCTAD argues that, for this linkage to be effective, national and international policies need to be rooted in a development-centred approach to trade rather than a trade-centred approach to development. An exclusive focus on trade integration, which assumes that poverty is reduced through more trade rather than through more development, is likely to prove ineffective. Rather, it is necessary to look at the relationship between trade and poverty from a development perspective.

The analytical core of this development approach is based on the insights that (a) differences in growth rates play a major role in explaining disparities in poverty reduction across regions and across countries, and (b) the effects of trade policy on growth proceed through links between trade and the accumulation of physical, human and organizational capital, as well as innovation.

As is recognized in the Monterrey Consensus, economic reform efforts in developing countries need to be supported by policy measures in developed countries and the international community at large in order to be conducive to attaining the goal of halving poverty. The industrial countries have a particular responsibility in this context, as their import barriers continue to discourage developing-country exports. Moreover, despite recent increases, official development aid and debt relief remain at levels that fall far short of needs.

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CONTENTS

A. Introduction

"Wealth is being created, but too many countries and people are not sharing in its benefits. They also have little or no voice in shaping the process. Seen through the eyes of the vast majority of women and men, globalization has not met their simple and legitimate aspirations for decent jobs and a better future for their children."

World Commission on the Social Dimension of Globalization, A Fair Globalization

"The poor countries that have liberalized their economies have shown impressive results, while those that have not are stuck in deep misery. Therefore, we need more capitalism and globalization if we want a better world, not less."

Johan Norberg, In Defence of Global Capitalism

"By concluding that openness tends to increase growth, we suggest that if poor countries opened more, poverty would fall."

Andrew Berg and Anne O. Krueger, Trade, Growth, and Poverty: A Selective Survey

1. The controversy about the effects of trade openness on poverty reduction has now seesawed between "it is good" and "it is bad" to reach the more nuanced position that "it is good if the right complementary policies are adopted". As this occurs, it is important to stand back and ask:

(a) Is it right to limit the analysis of trade and poverty to analysis of the effects of trade liberalization on poverty?

(b) Will it be possible to identify the most effective policies for linking international trade with poverty reduction if the analysis is limited in this way?

2. This Issues Note is founded on the view that the answer to both these questions is no, and that a broader approach to policy analysis of the links between trade and poverty is necessary.[1] The note outlines the current state of the debate on trade and poverty (section B) and identifies the limitations of the current approach (section C). Section D sets out the main elements of the development approach to the trade–poverty relationship and summarizes the analytical framework used in this document. Section E presents the policy implications of the development approach at both the national and international levels. The concluding section summarizes the major points and highlights issues/areas for further work on trade and poverty.

B. Trade, trade liberalization and poverty: where do we stand?

3. Since the fundamental change in economic policy in the late 1970s, trade liberalization has often been advanced as a prime source of income convergence across countries and as a key element of any development strategy. This advice is based on the expectation that the reallocation of resources according to comparative advantage will yield significant efficiency gains and welfare benefits. However, efficiency gains tend to be of a one-off nature. What matters, from a development point of view, is whether closer integration and faster expansion of imports and exports allows developing countries to catch up with the industrial countries, and the poor with the rich. The outcome of this

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[1] While drawing from UNCTAD's work generally, and in particular various issues of the *Trade and Development Report,* the note is essentially based on the analytical framework presented in *The Least Developed Countries Report 2004.*

policy advice has not lived up to expectations; a number of trends suggest that national economies are polarizing rather than growing closer together.

4. Until five years ago, most poverty analysis continued to focus on the role of national factors as causes of poverty and generally ignored the influence of international economic relations on poverty. In recent years, the drive to achieve the Millennium Development Goals, combined with pressure based on the perceived adverse social consequences of globalization, has been instrumental in bringing about extensive analysis of linkages between trade liberalization and poverty.

5. However, the danger in focusing poverty analysis on the effects of trade liberalization is that "unrealistic expectations will be created regarding what can be accomplished by trade policy alone" (Rodrik 1992: 103) and in particular by trade liberalization. Indeed, in practice, development – the long-term process in which people's incomes, productive capacities and freedom increase – is the key to sustained poverty reduction. While trade integration can play an important role in the development process, and while trade liberalization has figured prominently in recent policy debates, it would be wrong to assume that trade liberalization or increasing trade integration, as measured by the trade ratio of national income, is an end in and of itself, rather than a means to achieving development.

6. Therefore, to better serve the goal of poverty reduction, this analysis needs to move away from the narrow focus on trade liberalization and poverty towards analysing the relationship between trade and poverty from a development perspective.

C. The limits of the current approach to analysing trade–poverty links

7. The debate on trade and poverty has been advanced by useful contributions from both sides of the debate on the economic effects of trade openness, which have also yielded important policy insights. However, the current approach has limitations, as it:

- focuses on trade policy and poverty before examining the relationship between trade and poverty;
- takes trade liberalization as given and then examines how to make poverty reduction goals compatible with it, rather than emphasizing poverty reduction and then asking how trade liberalization might contribute;
- focuses on "openness"[2] of the economy, even though there are aspects of trade beyond "openness" that are important to poverty reduction; and
- offers only limited understanding of the indirect impact that changes in a country's level and pattern of trade, as well as the long-term dynamics of those changes, may have on poverty.

8. In short, while the current approach is helpful for understanding the problem of poverty alleviation during liberalization reforms, the most important effects of trade on poverty are likely to occur through indirect impacts and through long-term effects of sustained economic growth and development. The current approach stops short of explaining how to attain the international community's goal of achieving sustained halving of the incidence of poverty.

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[2] This term is the subject of considerable semantic confusion, as it is used to refer to both an economy's level of trade integration (measured by the ratio of imports and exports to GDP) and the level of trade restrictions (tariff and non-tariff barriers).

D. A development approach to the trade–poverty relationship

Elements of a development approach

9. The essence of a development approach to trade and poverty is that it begins with an analysis of how development occurs, rather than an analysis of how trade occurs, examining the role of trade within development processes and assessing the effects of trade on poverty from this perspective. The advantage of this approach is that it can build on existing policy analysis and research that examine international trade from a development perspective.

10. Seven basic elements constitute the development approach to trade and poverty put forward in this Issues Note:

(a) The issue of trade and poverty cannot be reduced to the issue of trade liberalization and poverty.

(b) Differences in growth rates play an important role in explaining disparities in poverty reduction across regions and across countries. The effects of trade policy on growth proceed through links between trade and the accumulation of physical, human and organizational capital, as well as innovation. Thus, sustained poverty reduction occurs through the efficient development and utilization of productive capacities such that the working-age population becomes more fully and productively employed.

(c) International trade can facilitate, hinder or modify this process.

(d) The relationship between trade and poverty varies with the composition of a country's international trade.

(e) The relationship between trade and poverty varies with a country's level of development as well as the structure of its economy.

(f) The relationship between trade and poverty is affected by the interdependence between trade on the one hand and international financial and investment flows, debt, and technology transfer on the other.

(g) Sustained development and poverty reduction are major motors for expanding international trade.

The basic analytical framework

11. The basic analytical framework of a development approach to the trade and poverty relationship has three components: international trade, development and utilization of productive capacities, and poverty. The latter is defined in a multidimensional way to include low income and consumption, lack of human development, vulnerabilities such as food insecurity, and insufficient availability of remunerative employment and social services. This framework includes direct and indirect links between trade and poverty. Trade affects poverty directly through its impact on the cost of living, jobs and wages, as well as government revenue, and indirectly through its effects on the development and utilization of productive capacities. While the direct links contribute to short-term poverty alleviation, the indirect links are crucial for sustained poverty reduction in most developing countries.

12. The development of productive capacities involves three basic processes: accumulation of physical, human and organizational capital; structural transformation; and technological progress.

13. Investment in the acquisition of ever-increasing stocks of various forms of capital is the basic component of increasing productive capacity. The process of capital accumulation entails investment in material capital equipment, but it also involves investment in human skills and health as well as institutional upgrading. The development of human capabilities is an integral part of the development of productive capacities. The development of institutional arrangements to transform natural resources and intellectual property into economic assets (through, for example, changes in property rights regimes), and the expansion of the social and organizational capital underpinning economic activity (for example, by creating business firms), are also important.

14. Capital accumulation can help raise per capita income and living standards in an economy simply by allowing fuller use of under-utilized labour and natural resources without altering the efficiency with which resources are utilized. Long-term economic success, however, depends on sustained improvements in productivity.

15. Historically, the process of sustained poverty reduction has been accompanied by structural changes in output and employment as a result of both shifts in economic activities across agriculture, industry and services and upgrading into higher-value-added activities within each sector through the introduction of new products and processes.

16. At any given moment, the level of development of productive capacities acts as a constraint on what goods and services a country can trade efficiently and also on the scale of trade. But international trade plays an essential role in supporting the efficient development and full utilization of productive capacities. This occurs through both exports and imports and may involve a variety of channels. The main traditional argument supporting the positive association between trade integration and economic growth relates greater openness and competition in international markets to improved efficiency as the result of both better resource allocation in the economy and, through the effects of competitive pressures, better use of resources at the firm level. Export expansion can also enable increased capacity utilization and the realization of a "vent for surplus" if external demand allows employment of labour and natural resources that were previously not utilized owing to a dearth of effective domestic demand. Given the dependence of most developing countries on foreign technologies embodied in imported capital goods, the development process will be seriously hampered if the financing of these imports poses a major constraint because the required export revenues cannot be obtained. This implies that the need to overcome the balance of payments constraint is a key factor underlying any export drive in developing countries.

17. Therefore, the role of trade integration in economic growth is particularly strong in the context of obtaining export revenue required to finance imports that in turn are required for industrial take-off, while gains related to improved efficiency, economies of scale from enlarged market size, or productivity-enhancing spillovers may represent additional gains. Trade can enable more efficient use of a country's resources by enabling imports of goods and services that, if produced domestically, would be more costly. It can lift a balance-of-payments constraint on sustained economic growth. It can improve returns on investment by reducing production costs or enabling economies of scale. Exposure to international trade competition can act as a spur to greater efficiency. Exports and imports can also be associated with the acquisition of technology.[3]

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[3] These different channels are rooted in different theories on the gains from trade.

18. The importance of moving away from a preponderant share of agriculture in output and employment and establishing a domestic industrial base lies in industry's potential for strong productivity and income growth. That potential derives, on the supply side, from a predisposition to scale economies, specialization and learning and, on the demand side, from favourable global market and price conditions. Moreover, some industrial sectors may have considerable forward and backward linkages with the rest of the economy. Successful development experiences have established a close relationship between the growth rates of industrialization and productivity, as well as between an acceleration of growth and a shift of labour from the low-productivity primary sector into higher-productivity industry.

19. Although changes in the structure of economic activity reflect some common underlying forces, there is also considerable potential for diversity across countries in the timing and extent of these changes, depending on the nature and composition of investment (both in machinery and equipment and in human and physical infrastructure), resource endowments, size and location. Foreign trade also exerts an important influence on the evolution of economic structure, insofar as it can help overcome domestic supply-side and demand-side constraints on industrialization and growth. However, as with investment, the extent to which trade feeds into a more or less dynamic and virtuous industrialization process owes a good deal to policy choices and interventions.

Variations among developing countries in the trade–poverty relationship

20. There is great diversity among developing countries in the interrelationships between international trade, productive capacities and poverty. International trade can facilitate or hinder the process of productive development and also modify the relationship between productive development and poverty reduction. Three dimensions of this variation are the following: the composition of the trade; the level of development and production structure; and the interdependence between trade and other international economic relations.

The composition of trade

21. The composition of trade is as important for the nature of the trade–poverty relationship as it is for the level of trade. This applies to both exports and imports.

22. Regarding exports, shifting economic activity away from dependence on the export of primary commodities towards manufactures has often been recommended to avoid the unfavourable movement in terms of trade that has frustrated the long-term growth performance of many developing countries. Manufactures now account for about 70 per cent of developing-country exports. However, what a country can earn from its trading activities depends on the global supply of the exported goods relative to demand. A simultaneous export drive by developing countries in manufactures, particularly of the labour-intensive category, could create a fallacy of composition problem – that is, on its own a small developing country can substantially expand its exports without flooding the market or seriously reducing the prices of the products concerned, but this may not be true for developing countries as whole, or even for large individual countries such as China and India. A rapid increase in exports of labour-intensive products involves a potential risk that the terms of trade will decline to such an extent that the benefits of any increased volume of exports may be more than offset by losses resulting from lower export prices, giving rise to "immiserizing growth". Potential oversupply in markets for manufactured exports from developing countries and ensuing policy responses have become important concerns in the design of export-oriented development policies that are coherent in terms of the global trading environment. Regarding imports, ensuring sustained economic growth will imply increasing dependence on imports of capital and intermediate goods. This, in turn, will require a rapid growth of export earnings and a steady expansion of export capacities.

23. However, export diversification may be particularly difficult for least developed countries (LDCs). Indeed, in very low-income economies that depend on a narrow range of low-value-added primary commodities and have deep mass poverty, there is a strong tendency for the domestic vicious circles of economic stagnation and persistent poverty to be reinforced by external trade and financial relationships. In this situation, trade can be part of an international poverty trap in which low and unstable commodity prices interact with unsustainable external debts and an aid/debt service system (see UNCTAD 2002). In some LDCs, for example, an examination of trends in real exports and average private consumption per capita has led to the identification of a type of trade–poverty relationship: an immiserizing trade effect where average private consumption per capita is falling along with export growth. *The Least Developed Countries Report 2004* has, for example indicated that the immiserizing trade effect is present in 18 out of a sample of 51 cases of LDCs in which exports grew in the period under consideration.[4]

24. In contrast, some more advanced countries that have managed to upgrade their commodity exports and diversify into exporting manufactures have been able to use international trade to achieve very high rates of economic growth. This occurs in particular in countries where there is a strong profits-investment and export-investment nexus (see UNCTAD 1996). In some countries there has been a virtuous circle in which increased manufactures exports lead to faster growth of manufactures output, which, because of the positive effect of the overall level of manufacturing output on labour productivity, induces greater productivity growth.[5] This in turn makes manufactures more competitive and enables increased manufactures exports.

The level of development and structure of production and employment

25. Divergence across different product categories regarding their exposure to adverse shifts in the balance between supply and demand on world markets implies that the relationship between trade and poverty also varies with a country's structure of production and employment. This overlaps with the composition of trade but is not quite the same thing.

26. Variations in the trade–poverty relationship among the developing countries owing to their structure of production and employment is also an important issue. In many developing countries, a large proportion of the poor work in agriculture and live in rural areas. This has led to the view that agriculture is the key issue for trade and poverty reduction, particularly in international negotiations. But from a dynamic development perspective, poverty reduction does not depend simply on agricultural productivity growth and improved employment prospects in agriculture: productivity growth and employment expansion in non-agricultural sectors are also important. Indeed, historically, most successful cases of sustained poverty reduction have involved a shift in the occupational distribution away from agriculture. In these cases, productivity growth has occurred in agriculture and other sectors of the economy in a balanced way such that there is a net addition to income-earning opportunities (jobs and livelihoods) on an economy-wide scale (Bhadhuri 1993).

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[4] In the report, there are only three LDCs – Bangladesh, Guinea and Uganda – in which the virtuous trade effect (with average private consumption per capita rising along with export growth) is observed during both 1990–1995 and 1995–2000. Moreover, in the sample of 51 LDCs in which exports grew, the virtuous trade effect is present in only 22 out of 51 cases.

[5] The relationship between manufacturing output and productivity, which was particularly emphasized by Kaldor, is known as Verdoorn's Law. It has been found in various settings; see Thirlwall 2002.).

Interdependence between trade and other international economic relations

27. Factors that extend beyond the realm of economic policies in developing countries also have an important impact on the trade and poverty relationship. How trade is related to poverty is affected by how trade is related to aid, debt, private capital flows and technology acquisition. For example, trade flows that are associated with foreign direct investment (FDI) building global production chains might have different poverty-reducing effects from trade flows associated with domestic entrepreneurs extending a local industrialization process to external markets. Similarly, imports based on tied aid might have different effects from imports financed out of export revenue.

28. These interdependencies matter for the trade–poverty relationship. From the point of view of developing countries, the knot through which the relationship between international trade and external finance is drawn together is the balance of payments. This critical constraint on development and sustained poverty reduction is conspicuously absent in the current debate on trade and poverty. Trade performance is also strongly linked to the level and stability of the exchange rate. Management of the exchange rate to achieve external trade and financial objectives is a key and complex issue.

29. Indeed, as is recognized in the Monterrey Consensus, economic reform efforts in developing countries need to be supported by policy measures in developed countries and the international community at large in order to be conducive to attaining the goal of halving poverty. More importantly, the industrial countries have a particular responsibility in this context, as import barriers in their countries continue to discourage developing-country exports, while liberalization initiatives by industrial countries would send a strong signal to developing countries about the importance and urgency of following up with their own reforms. Moreover, despite recent increases, official development aid and debt relief remain at levels that fall far short of needs.

E. Policy implications of the development approach

30. The major policy challenge now is to bridge the gap between the powerful role that international trade can play in principle to support poverty reduction in developing countries and its more ambiguous effects which can be observed in practice in many of these countries, particularly LDCs. Policy recommendations in the area of trade and poverty need to be formulated from a development perspective and thus be embedded in a broad and consistent framework that takes account of the interdependence between trade, finance, investment, technology and development.

National policies

31. A critical challenge facing most developing countries in the current context is how to promote development and poverty reduction in a newly liberalized market economy. Key issues, which require innovative thinking, are: What is the nature of a post-liberal development strategy? What kinds of public action can facilitate development and poverty reduction in an economy without barriers to international trade? These issues are urgent.[6]

32. There are a range of alternative open development strategies in which trade is an element of growth rather than the major source of growth, and which can be implemented in an open-economy

[6] As the Representative from a LDC to the United Nations and the World Trade Organization – who comes from a country that liberalized far and fast in the 1990s but still faces pressing problems in raising living standards, ensuring fuller employment and reducing poverty – recently put it in a statement at the WTO, “the majority of us [LDCs] are galloping in the darkness”.

trade regime in which incentives are not biased in favour of exports or imports, and in which there is no discrimination between the agriculture and manufacturing sectors.

33. The approach adopted here implies that national policies that will best support poverty reduction should not be based on an integration strategy alone but rather on a national development strategy with an integration component.[7] The aim of such a strategy should be:

- to create and sustain a dynamic process of capital accumulation, structural change and technical progress in order to develop productive capacities;
- to manage integration with the global economy, including both external finance and external trade, and technology acquisition; and
- to ensure that development is inclusive, incorporating marginal groups, paying attention to gender equity, and ensuring the achievement of certain minimum standards of human well-being, which are expressed in terms of poverty reduction, human development and food security.

34. Linking international trade to poverty reduction is best achieved through national development policies that are pragmatic, inclusive and outward-looking.

35. Pragmatic development policies are private-sector-led. However, they recognize that it is not only government failures that constrain development and poverty reduction. There are significant market failures as well. The most successful experiences of development and poverty reduction among developing countries have involved a combination of outward orientation with domestic intervention, the latter seeking to support rather than supplant market mechanisms.

36. Given the key role played by investment in the expansion of productive capacity and productivity growth, identification of the factors that govern investment decisions holds the key to the formulation of an effective development strategy.[8] Certainly, in a more open and integrated world economy, both the quantity and quality of investment are increasingly influenced by external factors. Premature broad-based trade liberalization can compromise capital accumulation because the business elite might favour the consumption of imported luxury goods, and premature trade integration can compromise upgrading and structural change and lock a country into production of goods with little productivity growth. Hence, gradual trade integration is required to ease, through increased exports, the balance-of-payments constraint caused by the need to import capital equipment that is required for industrialization.

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[7] This position is similar to that of Rodrik (2000), who identifies the shift from a concern with development to a concern with integration as a major weakness in current policy debates. As he puts it, “The trouble with the current discourse on globalization is that it confuses ends with means. A truly development-oriented strategy requires a shift in emphasis. Integration into the world economy has to be viewed as an instrument for achieving economic growth and development, not as an ultimate goal" (p. 28).

[8] In the past few years, there has been a major shift in the mainstream assessment of what constitute appropriate national development strategies. From the focus on moving towards increasing trade openness, emphasis has moved to the institutional and political context in which policy and accumulation decisions are made. This view is based on recent econometric work that looks at the influence of a broad range of institutional variables and finds a strong positive correlation between these variables, investment and income levels, which appears to be much larger than the effects of openness. However, concluding that “institutions rule” relative to openness (Rodrik 2002) is likely going too far. This is because of the limitations of openness measures that do not take into account the structure of protection, because of the evidence on the importance of technology transfer, and because of ignoring the differential effects that arise from trade integration depending on a country’s level of development and its place in the international division of labour at the time of trade integration. But the shift in emphasis towards investment and the determinants of investment is notable.

37. Successful poverty reduction also requires inclusive development policies. This is clear when the majority of the population is poor, but it applies even if the poor are only a small proportion of the national population. In this situation, targeting the poor rather than pursuing broad-based development may actually be counterproductive. First, it is clear that within a private-sector-led approach it is actually the behaviour of the rich that has an important impact on social outcomes. This comes partly through demand effects, but equally important are the ways in which the business class uses profits – whether for luxury consumption or reinvestment in ways that create more jobs for the majority (see UNCTAD 1997). Second, the narrow focus on the poor rather than on broad-based development may undermine the sense of national community, which has often provided the hidden ingredient of successful poverty reduction through development.

38. Finally, successful poverty reduction requires outward-looking development policies. The term "outward-looking" is used here to refer to policies that are based on constant attention to trade, technological and investment opportunities globally. An outward-looking policy is not necessarily the same as a policy of trade and financial liberalization.

39. In the case of LDCs, it is unlikely that an export-led growth strategy will of itself lead to a virtuous trade–poverty relationship. Export-led growth is generally synonymous with an exclusionary growth trajectory, with benefits concentrated in an enclave. However, an important argument of *The Least Developed Countries Report 2004* is that export-led growth is not the only promising open development strategy that can be pursued after trade liberalization.

International policies

40. The development approach also has implications for international policies, and in particular the design of the international trade regime. This requires attention not just to WTO rules but also to multilateral norms, rules and practices that go beyond WTO issues, including the working of the international commodity economy, preferential market access, the nature of regional trade agreements, and the transparency of mineral rents and revenues. That trade regime is founded on two visions of global justice (Helleiner 2003). According to the first, non-developmental vision, the purpose of the rules system is to provide stability and predictability for market participants, and to set certain restrictions on how national Governments may pursue their own diverse purposes. Economic freedom is seen as a good in itself, rather than as a means to development and poverty reduction. The second vision sees the rules system (and trade) as a means to an end rather than an end in itself, something that is instrumentally rather than intrinsically valuable. From this point of view, the purpose of the rules system is to facilitate positive development and poverty reduction outcomes. The critical question for negotiators designing the international trade regime would not be "How do we maximize trade and market access?" but rather "How do we enable countries to grow out of poverty?" (Rodrik 2001: 10).

41. If poverty reduction is taken seriously as the priority goal, then the development approach to trade and poverty outlined here has important implications for the design of the international trade regime. It implies that an international regime that facilitates the expansion of international trade is not sufficient for poverty reduction. Rather, it is necessary to have an international trade regime that does not constrain developing countries' national policies for developing their productive capacities. To be precise, the international trade regime should enable rather than constrain the efficient development and utilization of productive capacities in such a way that the working-age population becomes more and more fully and productively employed. What this means in practice depends on the relationship between international trade, the development of productive capacities and poverty reduction.

42. Improved international assistance for productive development and trade capacity building for competitiveness will contribute to both trade expansion and poverty reduction and will play a key role in improving the trade–poverty relationship in developing countries.

43. Finally, the development approach to trade and poverty implies that the international trade regime is not the sole international policy issue that needs to be addressed in order to link international trade more effectively with poverty reduction. Because the way in which trade is related to poverty is affected by how trade is related to aid, debt, private capital flows and technology acquisition, a central international policy issue is the question of coherence between actions in the different domains.

44. The interdependence between these domains implies that a slogan such as "trade, not aid" is misleading. The issue is not choosing one or the other. It is, rather, how to make any existing negative synergies between aid and trade into positive synergies, how to use aid to build productive capacities, and thus how, in the long term, to reduce the need for aid. Similarly, it is necessary to link trade with external debt problems. For the poorest countries in particular, the close connection between primary commodity dependence and the build-up of unsustainable debt is clear (see UNCTAD 2002). For middle-income countries, the links between growing trade deficits, excessive reliance on unstable forms of private capital inflows and currency crises are also evident (see UNCTAD 1999, 2002). These systemic links must be taken into account in the design of international policies that make international trade a more effective means of poverty reduction in developing countries. The fundamental priority is that governments in low-income countries formulate and implement national development strategies that incorporate trade in a manner that more effectively supports poverty reduction. Policy incoherence between international assistance policies and national trade objectives, insufficient and biased financial and technical assistance for trade, and the failure to facilitate and nurture national ownership of trade and development policies can all undermine national efforts to grasp opportunities created by changes in the international trade regime. Development partners need to support weaker countries through international financial and technical assistance to build both public and private trade capacities.

F. Conclusions

45. The narrow focus of the current approach to trade and poverty is hampering identification of the most effective national and international policies to ensure that international trade supports sustained economic growth, which is the key to substantial poverty reduction on a scale necessary to meet the Millennium Development Goals for poverty reduction.

46. This note argues that, in order to identify such policies, it is necessary to stand back from the subject of trade liberalization and poverty and focus objectively on the links between trade and poverty. It proposes a development approach to analysing the trade–poverty relationship. After this has been done, it is then possible to see how trade liberalization can fit into a broader development strategy.

47. The analytical core of this development approach is the idea that sustained poverty reduction occurs through the efficient development and utilization of productive capacities in a manner in which the working-age population becomes more and more fully and productively employed. International trade can facilitate, hinder or modify this process. This approach thus encompasses the long-term and indirect impact of trade on people's lives and livelihoods through the development of productive capacities, as well as the short-term and direct impact, which is currently considered in the literature

on trade liberalization and poverty. It makes trade and employment a central issue for understanding trade and poverty.

48. An important aspect of the approach is that it seeks to identify variations among developing countries in terms of the trade–poverty relationship. Three key dimensions of diversity are the composition of trade; the level of development and structure of production; and the nature of the interdependence between trade and financial and investment flows, as well as between trade and debt and trade and technology transfer. Finally, the approach encompasses analysis of the way in which poverty reduction affects trade.

49. There is need for more research on how the trade–poverty relationship varies with the composition of trade and the level of development, and on how these initial conditions fashion the type, scale, sequencing and timing of the different development and integration measures. Future work in this area needs to locate the trade-and-poverty issue within the context of:

- An integrated approach to the treatment of trade, investment and finance
- Recognition that a development approach to the trade–poverty relationship is the basic mechanism of poverty reduction
- A concern for equity and justice within the global economy.

50. There is scope for UNCTAD to build on its existing research strengths in specific aspects of the trade–poverty relationship. This includes work on the dynamics of trade and structural adjustment, trade and fiscal adjustment, trade costs and competitiveness, trade and employment, development-related aspects of the multilateral trading system, and the relationship between bilateral, regional and multilateral trade issues. Such research, complemented by targeted and pragmatic technical assistance towards national capacity building for policy and development strategy ownership and implementation, is a substantial agenda, but one with a potentially large return in terms of development and poverty reduction.

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