New UNCTAD Report Examines the Link between International Trade Expansion and Poverty Reduction in the World's Least Developed Countries

BACKGROUND

The mantra on the relationship between international trade and poverty reduction even in the least developed countries is given critical scrutiny in the new report issued by UNCTAD, *Least Developed Countries: Linking International Trade with Poverty Reduction.* The major theme thorough out the report is that trade expansion is not enough to reduce poverty in Least Developed Countries (LDCs).[1] There is a greater need for development led-approach to trade rather than a trade-led approach to development in the LDCs. The UN definition of an LDC is used: an LDC is a country with low income per capita, weakly developed human resources, and a high level of economic vulnerability.[2] All three of these criteria must be satisfied for a country to be classified as an LDC. Using this definition, some 49 countries, with a total combined population of 611 million (1997 estimate) are currently considered to be LDCs.

SUMMARY

The UNCTAD report acknowledges that international trade is vital for poverty reduction in all developing countries. But the links between international trade and poverty reduction vary between countries according to their production structure and level of development. For LDCs, the benefit generated from trade expansion/greater participation in international trade is just not strong enough to lift them out of extreme poverty. The convention that mass poverty found in most LDCs can be reduced through global integration and trade expansion is therefore an illusion. In support of this statement, UNCTAD asserts that foreign trade already constitutes a larger share of the GDP in LDCs than it does in high income OECD countries. Since the 1990s, LDCs have already undertaken extensive trade liberalization that in the reports view has left them with open trade regimes. Between 1999 and 2001, the average level of 'openness' or trade integration (ratio of exports and imports of goods and services to GDP) of LDCs was higher than those of OECD countries, 51 percent and 43 percent respectively. Although empirical analysis shows that export growth has been increasing in a large number of LDCs, their average private consumption per capita has remained stagnant or even decreased. The problem is that trade liberalization plus preferential market access does not equal to poverty reduction, at least in the LDC context.

COMMONLY ACCEPTED VIEW NOT TRUE, REPORT SAYS

A commonly accepted view on the relationship between trade liberalization and poverty is that trade liberalization in the short run will have an adverse effect on local economies and on social groups that formerly benefited from a protectionist tariff regime - but will be beneficial in the long run because trade liberalization will increase the growth potential of an economy. The report finds such views to be inaccurate for LDC for the following two reasons. For LDCs, poverty trends during and immediately after trade liberalization are very mixed, and not invariably negative, while GDP, investment and export growth rates are all higher in LDCs in the post-liberalization economic environment than in the pre-liberalization era. **So why is it, asks the report, that the benefits of trade are apparently not clearly trickling down and translating into poverty reduction in LDCs?** The report identifies both national and international factors that have failed to reduce mass poverty in LDCs. Export growth rates must not only improve, the increase should put the growth rate above a certain threshold level. Many LDCs have found it difficult to achieve and sustain export rate growth above the threshold needed for GDP per capita to be likely to grow. Below the threshold level of annual growth rate of 5%, there is a greater probability that export growth will be associated with declining GDP per capita than with increasing GDP per capita in the LDCs.

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Secondly, linkages are weak between export sector and the rest of the economy. In most LDCs, economic growth is concentrated in only a small part of the economy, either geographically or sectorally exemplified by specific activities (for example manufacturing, tourism, mineral resources). Thirdly, decreased aid flows may be offsetting the resource-increasing impact of export growth.[3] Almost all LDCs have large trade deficits which are being financed by aid inflows, and in such circumstances the positive effects of export growth on real income generation and capacity to import can be offset by decreased aid inflows (or increased debt service obligations). There is also a low level of investment and low investment efficiency. Finally, a high rate of population growth and the consequent need for high rates of employment generation are some of the reasons why continued poverty is persistent in LDCs.

Factors that will Lead to Sustainable Growth in LDCs

The UNCTAD report, while cautioning that trade expansion is not a poverty-reducing panacea for LDCs, does recognizes the potential for it to do more for poverty reduction than it currently seems to do to reduce extreme poverty in such countries. It argues that fundamental changes are needed to make international trade work for the poor in LDCs. The policy challenge facing most LDCs and their development partners is how to promote sustained development and poverty reduction that was achieved in India and China (which of course themselves had the advantage of being large economies). The three pillars of changes needed to achieve the task, according to the UNCTAD report are:

(1) Implementing better designed-post-liberalization development strategies by focusing on trade as a central component in LDC context. For example, the implementation of Poverty Reduction Strategy Papers (PRSP) prepared by LDCs involve policy actions focused on export led growth, based on trade liberalization and behind-the-border measures to reduce internal constraints to exports (such as high transaction costs associated with weak trade facilitation and port infrastructure), with the provision of social safety nets and investment in basic education and health. The UNCTAD report advises that PRSP papers should be focused towards long-term development strategy for increasing influence on the absorption of labor into the modern sector, narrowing the rural-urban income gap and reducing the degree of income inequality within sectors.

(2) Reforming the international trade regime to reduce international constraints on the development of LDCs. Improvements to the international trade regime, according to the UNCTAD report, include the phasing out of agricultural support measures by developed countries on products that affect LDC economies (e.g. to mention a few on products such as beans, beef, cotton, maize, potato, rice, sugar, wheat), implementation of new international policies to reduce vulnerability to commodity price shocks, enhancing South-South cooperation, and implementing initiatives to ensure greater international transparency in the use of revenues derived from oil, gas and mineral exploitation.

(3) Strengthening and increasing financial and technical assistance for developing domestic production and trade capacities of the LDCs. In 2002, the WTO/OECD database on aid for trade related technical support indicates that commitments to support trade policy formulation and trade development in the LDCs were only 0.5 percent and 1.5 percent respectively, of total aid commitments to these countries. The report reinforces the idea of shifting aid towards building production and trade capability.

HOW TO ACCESS THIS REPORT: The full document of the *Least Developed Countries: Linking International Trade with Poverty Reduction, UNCTAD Report 2004* and previous publications can be accessed at: http://www.unctad.org/en/docs//ldc2004_en.pdf

See next page for endnotes.

ENDNOTES

[1] These used to be called "Least Developed Countries" and were assigned the acronym LLDC. Use of the acronym LLDC has faded, and LDC (which once stood for "Less Developed Country") now stands for "Least Developed Country."
[2] Operationally, low per capita income is defined as 3-year average per capita GDP's being less than $750 (though in some cases as high as $900 since attainment of $900 per capita income is a requirement for "graduating" from the LDC classification). Low human resource level is defined as having a low score on a composite augmented physical quality of life index (APQLI), while economic vulnerability is evidenced by export and agricultural production instability, small population size (less than 75 million), and a number of other factors.   Large countries (population greater than 75 million) are generally excluded from the UN's LDC grouping (although Bangladesh is an apparent exception), since they are considered by virtue of their size to not be highly economic vulnerable. This alone would keep the following low income countries from being LDCs: China, India, Indonesia, Nigeria, Pakistan, with a combined population total of about 3 billion.
[3] Do increased export revenues tend to be associated with decreases in aid flows?   The report seems to suggest that this is the case. But why should this be so? There are various possible explanations. Donors may cut back on aid as they see the LDC's exports increase. Or exports may increase in reaction to aid cutbacks. Other things being equal, a reduction in aid inflow would tend to result in a depreciation of the real exchange rate, which would provide a stimulus for export expansion by the LDC.