

## Executive Summary

Trade can be a powerful engine for economic growth, poverty reduction and development. Although debated, this is the main conclusion of a large body of empirical literature on trade and growth. Harnessing the power of trade is often difficult for developing countries, particularly the least developed ones, because of supply-side domestic constraints. The Aid for Trade Initiative launched in 2005 at the Hong Kong WTO Ministerial Conference addresses these constraints.

Aid for Trade interlocks aid and trade in a broader pro-growth strategy whose overall objective is to raise living standards and reduce poverty in developing countries. To increase the impact of trade on poverty reduction, the international community has acknowledged that trade integration is an important element in achieving sustained economic growth, and that Aid for Trade provides an important framework to support this process by addressing constraints in developing countries that keep them from taking advantage of new economic opportunities arising from expanding regional and global markets.

The background of this report on *Trade for Growth and Poverty Reduction: How Aid for Trade Can Help* is presented in Chapter 1.

Chapter 2 shows that achieving the four most common objectives of aid-for-trade programmes and projects has the potential to boost growth in developing countries and to reduce poverty. These four aid-for-trade objectives are: (i) increasing trade; (ii) diversifying exports; (iii) maximising linkages with the domestic economy; and (iv) increasing adjustment capacity. The literature provides ample evidence to support this.

Trade is a means to an end, not an end in itself. As discussed in Chapter 3, the end is the achievement of sustainable growth and, through appropriate complementary policies, poverty reduction – as well as more equitable distribution of global benefits across and within developing countries. The impacts of trade reform and expansion on the poor are context-specific, depending on consumption patterns and on whether trade-induced growth occurs in areas and sectors where the poor live and are economically active. Consequently, strengthening the contribution of trade to pro-poor growth

requires national policies that link poor women and men with trade opportunities and targeted trade-related international support, such as Aid for Trade.

For the poor to share in the gains resulting from integration, complementary policies to help connect them to the economic process need to be in place. These include policies aimed at enhancing their productive capacity and better integrating them into domestic, regional and global markets, thus boosting incomes. Depending on the country context, this could require further investments in human capital and rural infrastructure, access to credit and technical assistance, and safety nets and policies to promote macroeconomic stability. Such policies, which reduce the risk and vulnerability of the poor, can help them adjust to structural changes and take advantage of opportunities created through further market opening. Essentially, Aid for Trade is an important component of a pro-poor development strategy and should support trade that will contribute to growth and to poverty reduction.

While most countries benefit from opening up to trade, some are unable to benefit from trade opportunities, as demonstrated in Chapter 4. Developing countries often face two types of constraints that Aid for Trade should address. First, it can be difficult for them to turn trade opportunities into trade flows because of capacity constraints and lack of adequate trade-related infrastructure. Second, some domestic constraints choke the impact of trade expansion on economic growth. The report focuses on the first set of constraints. The various diagnostic tools available to identify constraints on trade expansion are discussed in this chapter. Stakeholder consultation, benchmarking, the Diagnostic Trade Integration Studies (DTIS) method and value chain analysis can be used to pinpoint the trade-related needs and constraints that prevent developing countries from expanding trade (as defined by the four most common aid-for-trade objectives). All of these methods have advantages, but they also have shortcomings and limitations.

The use of diagnostic tools often produces a long list of constraints. As all constraints cannot be addressed simultaneously, there is a need to identify those that are the most binding. The report suggests combining diagnostic tools in an appropriate framework to achieve this prioritisation. Combining them can help overcome the shortcomings and limitations of each individual tool. It can also provide evidence for use in confirming the conclusions of any single approach and reduce the risks of misdiagnosis or capture by vested interests. Finally, combining diagnostic tools can identify the most binding constraints on which aid-for-trade interventions and reforms should focus first.

An adaptation of the growth diagnostics framework developed by Hausmann, Rodrik and Velasco to guide growth strategies could serve as an appropriate framework for doing so. By shifting the focus from growth to trade, this framework can be readily adapted by local authorities and development practitioners. A decision tree is employed to prioritise reforms and obtain “the biggest bang for the reform buck”. At each node of the decision tree, stakeholder consultation, benchmarking and a value chain approach can be used to rank constraints. Drawing on a tool from the Enhanced Integrated Framework (EIF) for trade-related technical assistance to least developed countries, a Diagnostic Trade Integration Study (DTIS) action matrix can then be used to identify needed actions and reforms, as well as sources of potential external financial support and technical assistance. This approach has the advantage of increasing participation and ownership by stakeholders, a key principle of the 2005 Paris Declaration on Aid Effectiveness. Consequently, it can improve the chances that reforms and aid-for-trade interventions will be successful.