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# Trading Out of Poverty How Aid for Trade Can Help

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## **EXECUTIVE SUMMARY**

1. Economic growth is the most important single factor for poverty alleviation. Depending on its pace and pattern, growth creates more and better productive employment opportunities, allowing it to make sustained inroads into reducing poverty. Furthermore, there is a growing consensus about the positive links between openness to trade and economic performance. This is particularly true for low-income countries that lack a sufficiently large domestic market. In these countries, the creation of employment opportunities, including for poor men and women, requires an expansion of the domestic market through international trade, both regionally and globally. In addition, trade serves as a conduit for the transfer of foreign technologies and know how, which enhances domestic productivity, and increased international competition stimulates domestic companies to become more competitive. However, one needs to bear in mind that the impact of trade on income (and poverty) depends on many factors and can be positive, negative or neutral depending, *inter alia*, on local conditions.

2. Traditionally, the debate on the links between trade, economic growth and poverty reduction has been dominated by a discussion on the impact of trade liberalisation on poverty reduction. This is not surprising as trade liberalisation is the most obvious policy instrument for increasing trade capacity. This paper, however, focuses on what we know about the impact of trade on economic growth and poverty reduction. More specifically, the paper reviews the empirical evidence underlining the impact of trade on pro-poor growth – in other words, the pace (rate) and pattern (distribution) of growth, both within as well as between countries. It also discusses the potential role of aid as an instrument to build the capacity of low-income countries to trade, to help the poor take advantage of new opportunities created, or to protect them against potential adverse effects. The paper maintains that Aid for Trade is an important component of a ‘pro-poor’ development strategy.

3. Some of the key findings of empirical work on these questions are summarised below. In many ways, the evidence concerning trade is a mirror of that concerning the impact of economic growth on poverty reduction. In general, trade has a positive impact on growth though the magnitude of the impact varies considerably across countries; evidence on trade’s impact on poverty is mixed

- Trade contributes to economic growth. There is a strong correlation between trade openness and economic growth. Almost all non-oil producing countries with good growth records have integrated well into the global economy. Greater openness to trade is clearly associated with faster economic growth. However, causality between trade and growth performance remains statistically a difficult issue and it is not always clear whether trade or some other growth driver is the culprit when performance on poverty reduction or inequality is disappointing.
- However, the degree to which trade benefits growth and poverty reduction happens varies considerably across countries. In particular, the LDCs (compared to other groups of developing countries) have been integrating well into the global economy but without the concomitant impacts on the volume and diversity of their exports that other developing countries have experienced. Countries can fail to benefit from trade for a variety of reasons – e.g. the impacts of OECD country trade policies, the impacts of the trade policies of other developing countries, and structural weaknesses in their own economies (including supply-side constraints, policy and institutional deficits, weak human capacities and assets, and geography).

- Overall, the evidence on the impact of trade on poverty and inequality is mixed. On average, the poor do as well as others from growth, but there are large variances. Clearly, there is no a priori reason to anticipate that growth from trade, or from any other factor for that matter will automatically benefit the poor. Poverty effects depend on what the poor consume, produce, earn from assets, including their labour, receive in transfers (private and public), and what they can do about variability and adjustment strains.

4. The Aid for Trade initiative was specifically created to overcome the barriers that constrain countries' ability to benefit from trade expansion. Aid for Trade can also help countries address the differentiated impact that trade expansion can have on poor people, across and within countries. Potential approaches to improve the impact of trade on the poor include assistance to increase the productive capacity of poor men and women, to connect them better to markets, facilitate their adjustment by putting in place social protection policies (to help them cope with and make adjustments) and improve education and healthcare. It should be borne in mind, however, that poverty traps are multi-dimensional and inter-generational and not all of them are amendable to improving economic opportunities through trade.

5. Key policy messages on promoting a stronger impact of trade on economic growth and poverty reduction include:

- The need to build productive capacities. In order to achieve a sustainable supply-side response and concomitant expansion of productive employment opportunities, the development of productive capacities – *e.g.* human capital and entrepreneurial capabilities, infrastructure, production linkages/value chains – is of foremost importance. Together, such capacities determine the ability of a country to trade, and enable it to grow and further develop.
- The importance of markets for determining the poverty reduction impacts of trade. Connecting poor farmers to markets and enabling them to sell their crops provides significant benefits. Therefore, what's needed is a set of marketing policies, institutions, as well as investment in rural infrastructure to help reduce transport and energy costs and risks and connect farmers to markets, so as to better transmit the opportunities created by market opening and maximise potential gains against poverty.
- Finally, the need for balancing trade and growth with sustainable development benefits. It is essential to pay a closer attention to the differential impact of trade on different sub-groups of people, from the angles of employment, gender and geography. Trade policy interventions, if they are to have a greater pro-poor impact, need to consider the country-specific profile and needs of the poor and the many roles they play as consumers, workers and producers.

6. Trade is a means to an end, not an end in itself. The objective is sustainable growth and, through appropriate complementary policies, poverty reduction. Consequently, strengthening the contribution of trade to pro-poor growth requires national policies linking poor women and men with trade opportunities and targeted trade-related international support, *i.e.* Aid for Trade. The aim is to enhance growth prospects and reduce poverty in developing countries and distribute the global benefits more equitably across and within developing countries.

## **TRADING OUT OF POVERTY: HOW AID FOR TRADE CAN HELP**

*“The property which every man has is his own labour; as it is the original foundation of all other property, so it is the most sacred and inviolable... To hinder him from employing this strength and dexterity in what manner he thinks proper without injury to his neighbour is a plain violation of this most sacred property.”*

The Wealth of Nations, Book I, Chapter X, Part II (Smith, 1776)

*“For many people economic poverty is rooted in their inability to trade – and trade is a vital route out of poverty.”*

Trade Matters (DFID, 2005)

### **1. Introduction**

1. There is little doubt that economic growth is the most powerful tool to reduce poverty. It is also true that no country has successfully developed its economy by turning its back on international trade and long term foreign direct investment. Virtually every country that has achieved sustained economic growth has done so by seizing the opportunity offered by more open world markets. However, many low-income countries are still confronted by major obstacles in expanding and diversifying their trade. Moreover, trade reform and liberalisation has not always delivered the expected benefits in terms of trade expansion, growth and poverty reduction. Against this backdrop the international community has agreed to expand and improve Aid for Trade to help developing countries, particularly the least developed, build the supply-side capacity and trade-related infrastructure needed to expand their trade and to benefit from their integration into the world economy.

2. Aid for Trade has been designed as a tool to interlock aid and trade policies into a coherent strategy for raising living standards and reducing poverty. It should be used as tool to ensure that the benefits of trade policies do materialise, particularly when traditional trade policy reform tools on their own are insufficient to deliver the expected benefits from trade expansion. Aid for Trade is a tool to tackle the supply-side constraints of low-income countries unable to expand their trade in response to market incentives, and is a tool to address distributional challenges such as the differentiated impacts of trade reform and development on poverty.

3. When an economy is generating greater output, creating more and better productive jobs and providing opportunities that the poor can take up, it is in a better position to make sustained inroads into reducing income poverty and tackling other social and economic problems. However, while this relationship is strong, it is not automatic. The impacts of trade reform and expansion on the poor are particularly context-specific, according to consumption patterns of the poor, and on whether trade-induced growth occurs in areas and sectors where poor women and men live and are economically active.

4. Although trade-related assistance has been around for some time, few bilateral donors have explicit trade objectives incorporated in their aid programmes and even fewer have programmes that are aimed at engaging the poor directly in trade-related activities. Not only the potential impact of Aid for Trade on poverty reduction needs to be better explained, donor agencies, too, need to better integrate trade

expertise in their country programmes and operational teams.<sup>1</sup> This mainstreaming is particular pressing as OECD donors have pledged to provide additional resources to help low-income countries overcome their binding trade-related constraints in their efforts to achieve the Millennium Development Goals (MDGs).<sup>2</sup>

5. The objective of this paper is to raise awareness among donors and partner countries about the potential contribution of trade to economic growth and development, the challenges of realising that potential, and the role of Aid for Trade in addressing those challenges. The paper presents a rationale for donors to provide ‘more and better’ Aid for Trade, and explains why Aid for Trade can be an important instrument in a pro-poor development strategy.

6. The remainder of the paper is organised as follows. The next section demonstrates why trade matters for boosting productivity and economic growth. Section 3 highlights that while many countries benefit, some countries are unable to benefit fully from trade. Sections 4 through 6 analyse how Aid for Trade can help strengthen the impact of trade on growth and poverty reduction, and which policy tools can best reinforce the impact of trade on poverty reduction, such as building productive capacities, connecting the poor to markets, and mitigating the costs of adjustments. Section 7 considers the need to address the distributional impact of adjustment costs, particularly in cases where they affect the most vulnerable segments of the population. Section 8 underlines the need for a tailored, country-based approach to economic integration. Finally, Section 9 concludes by summarising the main policy conclusions.

## 2. Why trade matters

7. For almost all countries, trade is an important source of wealth generation, as well as an important means to self-sustained growth and poverty reduction. To begin with, access to larger and richer foreign markets is key to enable domestic firms to generate the level of demand required to exploit economies of scale which, in turn, create the opportunities for sustained economic growth. This is especially true for low-income countries with small domestic markets. More importantly, trade allows developing country firms to access technologies that are essential for improving their productivity and competitiveness which will generate growth and employment opportunities, including for poor men and women.<sup>3</sup> Furthermore, as the experiences of newly industrialised economies in Asia has demonstrated from the 1960s through to the 1990s, latecomers can – with the right preconditions and determinants – take advantage of the newest technological development and simply buy technology for its own industrial development at a relatively lower cost and less risk.<sup>4</sup> (Lin, 2007; UNIDO, 2007)

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1. UNCTAD (2004) highlighted “an urgent need to strengthen donors’ own trade-related capacities” arguing that “[m]ainstreaming trade in aid programmes is as important and urgent as mainstreaming trade in RSPs.”
  2. The Millennium Development Goal 8, in particular, holds greater significance in the context of the Aid-for-Trade initiative as it addresses both the issues of trade and aid, *i.e.* Target 12 for ‘developing an open, rule-based, predictable, non-discriminatory trading and financial system’ that works for developing countries, Targets 13 and 14 for addressing the special needs of LDCs, landlocked and small island developing countries, and explicitly calls for a proportion of ODA (Aid-for-Trade) to be allocated to help build trade capacity *via* MDG Indicator 41.
  3. Rodrik (2007) identifies the process of acquiring/importing and adapting advanced foreign technologies as perhaps the most compelling mechanism that links trade with growth in developing countries.
  4. In addition, such acquisition of foreign innovation can, in turn, result in faster upgrade of the country’s endowment, industrial and technological structures, though, on the condition that it undertakes ‘process innovation’ to endogenise the borrowed technology so as to suit its local conditions and be consistent with its comparative advantage. (Lin, 2007)

8. Exports, on the other hand, are the most important means to earn the necessary foreign currency to finance imports of capital and intermediate goods with embodied modern technology. Furthermore, competition drives the productivity growth of enterprises, and Bigsten *et al.* (2004) have shown that trade can also, through efficiency gains from learning by exporting, improve productivity. The resulting greater efficiency of domestic firms benefits consumers, including the poor, through lowering of prices. Of course, exports must grow in line with demand for imports, otherwise a country will be threatened by the build-up of an unsustainable external debt, which can undermine the sustainability of economic growth. (McCulloch, Winters and Cirera, 2001; Oxfam, 2002)

9. Since 1980, the global market for goods and services has expanded dramatically with world trade growing five times in real terms and its share of world GDP rising from 36% to 55% over this period. (IMF, 2007) Falling transportation and communications costs have been major drivers, making it easier and less costly for traders to search out and reach foreign markets. Similarly, the lowering of trade barriers has accelerated deeper integration in the 1990s as fast-growing developing Asia, notably China and India, and former Eastern bloc countries progressively integrated into the global trading system. Those same forces also contributed to a massive increase in services trade, though from a much smaller base, as global sourcing of and foreign investment in services have both surged.

10. Nevertheless, the evidence also shows that such success does not apply to all developing countries, nor to all social groups within those countries. Furthermore, while both low- and middle-income countries have made substantial progress in dismantling their trade barriers over the past two decades, this has not appeared to unleash sustained export growth in all of them. (World Bank, 2007) Such heterogeneity of outcomes is the main underlying reason why there is no consensus in the literature about the quantitative impact of trade liberalisation upon economic growth (see Box 1). Most empirical studies have failed to establish a systematic relationship between the two, and doubts about the direction of causality remain. Technically, econometric regressions in this field are difficult given that most explanatory variables are somehow endogenous.<sup>5</sup>

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5. Quantitative analyses on the impact of aid on economic growth confront similar challenges and have also arrived to contradictory policy conclusions according to differences in the model specifications (see e.g. Roodman, 2007).

### **Box 1. Trade, Growth and Poverty Reduction: Where Do We Stand?**

Does trade liberalisation lead to economic growth and poverty reduction? The vast literature on this topic has been summarised as depending on “how one interprets recent economic history and the role that trade openness plays in the course of economic development.” (Rodrik, 2007).

With respect to the relationship between trade and growth, most empirical studies have failed to establish a systematic relationship between greater integration and growth, and there is little agreement on causality. The complexity of interpreting the causal relationship is hardly surprising because *i*) while trade integration may cause growth, causality may equally go the other way, and *ii*) other factors may affect both trade and growth in a similar manner. For instance, Bhagwati and Srinivasan (2001) argue that cross-country studies face problems in defining and measuring openness, identifying causality, as well as isolating the effects of trade liberalisation. When these are brought together in growth regressions, the average result becomes fuzzy. Which is why, they conclude, regression analysis is not seen as an appropriate method for examining the complex relationship between trade liberalisation and growth.

Another major source of disagreements lies in the difficulty in finding a proxy (the measurement) of trade openness that is robust and universally acceptable. For example, although some research in the 1990s seemed to confirm that trade liberalisation promoted economic growth, Rodriguez and Rodrik (1999) maintained that the results were based on variables that poorly reflected trade liberalisation.

Neither is there a simple and general conclusion from the literature on the causal link between trade and poverty, be it directly between the two or through the impact of the former on growth and, in turn, on poverty. Here too the evidence presented in several recent surveys is weak (e.g. Bannister and Thugge, 2001; Berg and Krueger, 2003; Winters, McCulloch and McKay, 2004). The relationship between trade and poverty is likewise extremely complex and case-specific, making systematic empirical analyses rather difficult in practice. (Turner, Nguyen and Bird, 2008) At best, these empirical studies are only able to test for the indirect linkages between open trade (changes in trade volume) and poverty (changes in income share of the poorest), and found little significant evidence of robust associations between the two beyond the effect of openness on overall growth.

Put differently, although the poverty elasticity of growth can vary significantly between countries and across time (see e.g. World Bank, 2005), there is no evidence-based support for a consensus that liberalised trade has an ‘adverse’ impact on the poor. Cashin *et al.* (2001) examined the relationship between macroeconomic policies and improvements in a human development index for a given rate of per capita GDP growth and found no robust evidence that any openness variable was associated with either pro-poor or anti-poor growth. Cling (2006) also concludes, on the basis of a comprehensive literature review, that trade is not the main factor determining the evolution of poverty and inequality within countries.

However, the IMF (2007) analyses found that trade openness actually reduces income inequality, both in developed and developing countries. In fact, during the last two decades average real income of the poorest segment of the population has increased across all countries and income groups. Rather, as the study points out, income inequality has risen in most countries and regions over the past two decades due to technological progress which increases the wages of the skilled relative to the wages of the unskilled.

Whether openness is a cause or a consequence of economic growth is not purely an econometric issue. However, despite differences of opinion among academics, they do see eye-to-eye on one thing, that the benefits countries can gain by opening up their economies are real. Indeed, the weight of evidence to date does point strongly in the direction that: greater openness is an important element explaining growth performance and has been a central feature of successful development. Put differently, no country has developed successfully by closing itself from the rest of the world, very few countries have grown over long periods of time without experiencing a large expansion of their trade<sup>6</sup>, and most developing countries with rapid poverty reduction did sustain high economic growth (*i.e.* the growth in income accounts for a large share of observed changes in poverty reduction).

<sup>6</sup> See also ‘The Growth Report: Strategies for Sustained Growth and Inclusive Development’ from the Commission on Growth and Development (2008) for further evidence on the importance of trade openness and successful integration into the world economy in the 13 countries selected for their fast growth rate over long periods of time.

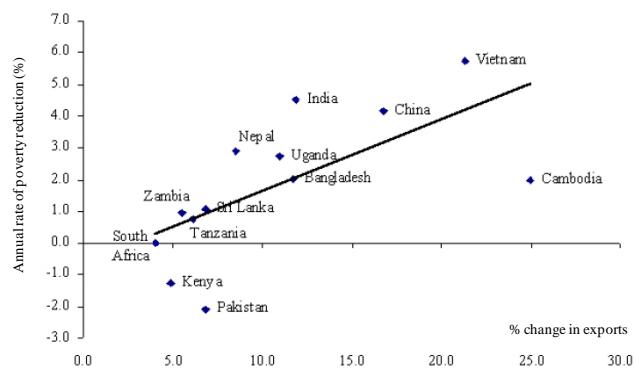
11. Still, despite differences of opinion on the strength and the direction of causality in the link between trade and growth, the empirical evidence offers no basis for restricting trade. On the contrary, there is sound evidence that economic growth is accompanied (and facilitated) by increasing imports and exports which, in turn, points to the strong presumption that openness to trade generally leads to welfare gains. (Rodriguez and Rodrik, 1999; Winters, 2004) Therefore, the continued debate on the issue of trade-growth causality should not distract the aid community from the importance of the role of trade as a potential driver of sustained and robust economic growth in developing countries, but instead focus its mind to address the cases where trade is failing to live up to its potential.

12. Indeed, the focus should be *what works, how, and under what circumstances*. For instance, recent country case studies confirm that the link between export growth and poverty reduction has been mostly positive, but there are nonetheless some negative cases, indicating that other factors may be hindering the impact of trade or are much more important in determining the process of poverty reduction (see Box 2). It is also important to be mindful of the fact that the gains from trade mostly emerge from a process of reallocating resources from least productive to most productive sectors. That means that, in general, the benefits of trade are not distributed equally, creating as a consequence losers and winners within countries. Moreover, in the case of liberalisation processes, the losses are often more visible because they are easier to predict, earlier to materialise, and more concentrated on a few compared with the often more thinly spread benefits.

#### **Box 2. Export growth and poverty reduction in selected Asian and sub-Saharan African countries**

A series of country case studies by CUTS International (2008) has examined the links between the growth of exports and poverty reduction over various spells for which information is available in 13 developing countries in Asia and sub-Saharan Africa. The figure below plots the annual rate of poverty reduction and export growth in the 13 case study countries. A positive relationship between the growth in exports and reduction in poverty is visible for most countries with Vietnam performing the highest in both indicators. To a lesser extent this strong positive relationship also applies to China and India. Despite their more modest performance in export growth, Nepal and Uganda, too, have experienced impressive reduction in poverty. Sri Lanka, Tanzania and Zambia have both low export growth and low poverty reduction rates, but still positively linked.

There are exceptions, however. Kenya and Pakistan actually experienced deteriorating poverty levels. Cambodia, on the other hand, is a clear outlier as it experienced the highest export growth rate with only a modest rate of poverty reduction (at par with that of Bangladesh). These cases highlight the fact that there are other factors than trade which influence poverty reduction differently. In short, the evidence from these case study countries suggests that despite the general positive link between export growth and poverty reduction, this relationship is also influenced by other factors, which in some cases appear to be rather strong.



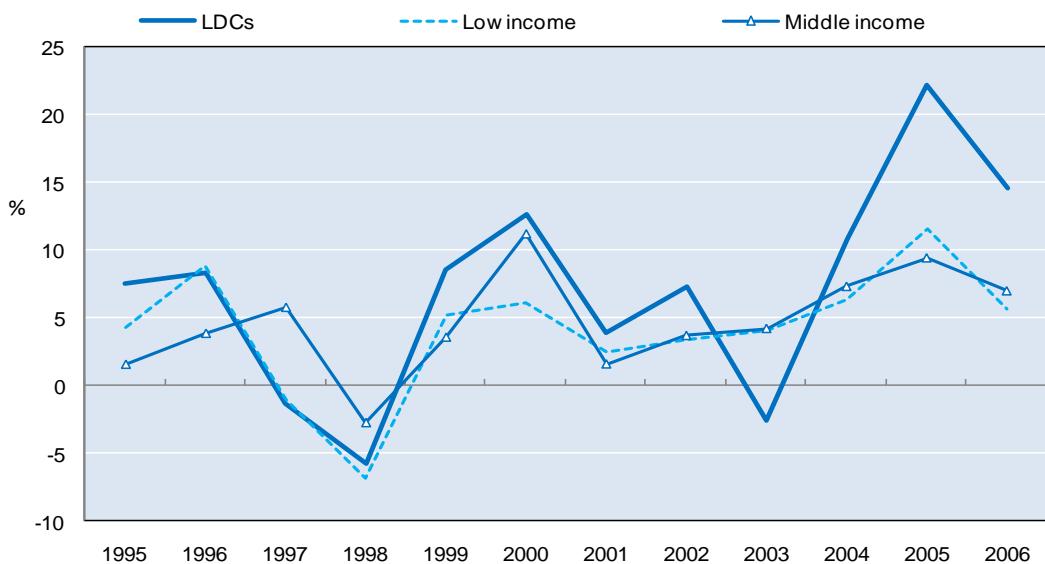
Source: CUTS, 2008 (p. 24: Figure 1.10)

### 3. When does trade not deliver?

13. It is clear that many low-income countries have benefited from the expansion of global markets and shared in the prosperity generated by globalisation. The steady reduction in trade barriers, particularly in manufactured goods, has enabled them to rapidly integrate into world markets through an export-led industrialisation processes. However, although a certain or minimum degree of openness is necessary to trade successfully, the evidence shows that openness alone is not a sufficient condition, especially for poor economies. For instance, the national economies of most low-income countries are actually highly integrated with the rest of the world through trade (Figure 2) and their exports have been growing faster than the world average in recent years (Figure 1). Yet, many still face major difficulties in expanding (in absolute terms) and diversifying their exports, in some cases, prompting their marginalisation in world trade (Figure 3).

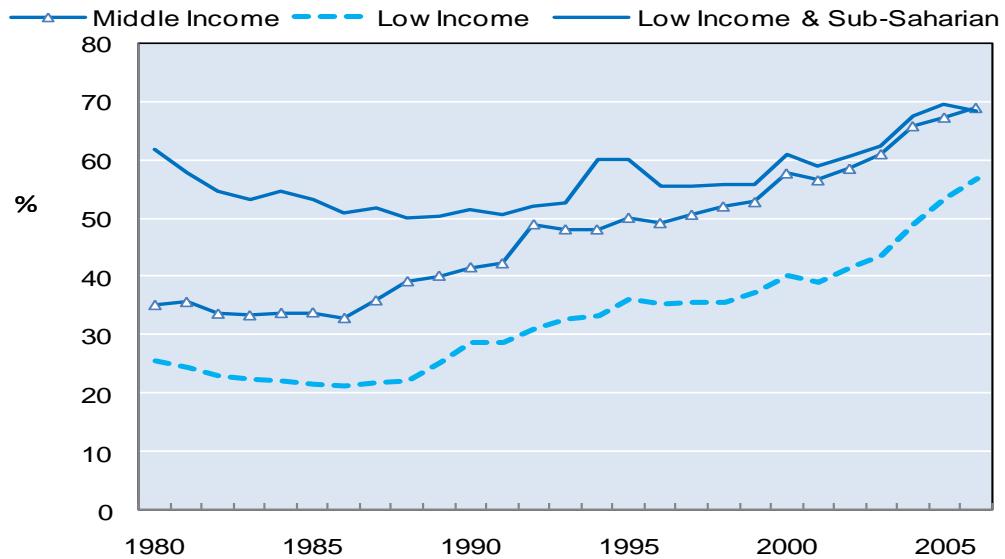
14. For example, sub-Saharan Africa's share of world exports halved between 1980 and 2006, falling from 3.9% to 1.9%. The situation is even worse for the African LDCs whose aggregate average share fell by one-third from already meagre 0.06% to 0.024% over the same period. The decline in the share of poor countries' exports is even more worrying, when considering that it took place against a dramatic rise of developing countries' exports in world trade. As shown in Figure 3, exports per capita in middle income countries have dramatically increased but have slightly decreased in sub-Saharan African low-income countries. Given that low-income countries in sub-Saharan Africa have been relatively open to trade since the 1980s, their poor performance in trade (and persistent mass poverty in those countries, for that matter) does not seem to be due to insufficient openness. The question then becomes why some countries under-export, or are unable to diversify their exports out of a narrow list of commodities.

**Figure 1. Relative annual export (goods and services) growth (world average = 0)**

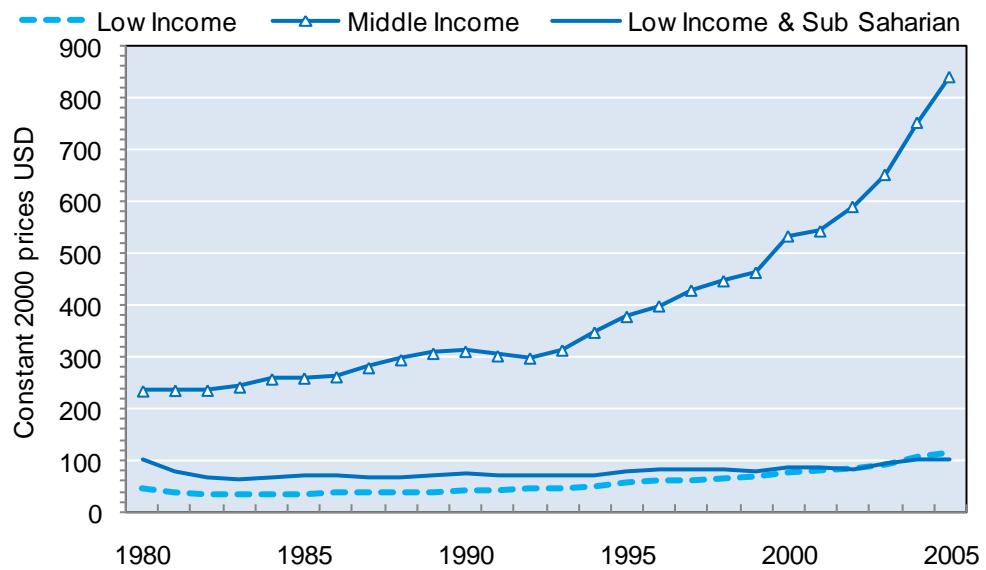


Source : World Development Indicators, World Bank

**Figure 2. Trade as a percentage of GDP**



**Figure 3. Exports (goods and services) in constant prices per capita (1980-2005)**



Source: World Development Indicators, World Bank

15. There are still important parts of industrial countries' trade policy that constrain the ability of developing countries to more fully participate in international trade. For instance, the removal of trade restrictions and policies that penalise products from developing countries should bring about considerable benefits to those countries and, in turn, should help reduce poverty. Further opening of agricultural markets typically has the strongest effects on the development of low-income countries as the bulk of the poor finds employment and derives their incomes from that sector. Moreover, tariff escalation impedes poor countries from moving up the value chain to enter into more dynamic, higher value-added markets. As Collier (2007) put it: "It is stupid to provide aid with the objective of promoting development and then

adopt trade policies that impede this objective”. Therefore – and as agreed by the MDGs – such examples of ‘policy incoherence’ need to be corrected (see footnote 2).

16. Furthermore, the relatively high trade barriers faced by imports between developing countries suggest that further liberalisation of South-South trade can also contribute substantially to meeting development objectives. In other words, trade restrictions are not only a North-South issue and there are important gains too from South-South reductions. Moreover, welfare gains from South-South trade integration are also likely to be associated with less pronounced relative price changes and thus less severe structural adjustment costs. This can open up possibilities for learning-by-doing and developing economies of scale to break into higher value-added markets in the North.<sup>7</sup> (Kowalski and Shepherd, 2006)

17. However, despite the remaining trade barriers, the fundamental structural weaknesses of low-income countries (*e.g.* various supply-side constraints, low levels of human capital, poor governance and institutions, lack of incentive structure, high cost of doing business) coupled with their infrastructure – and for some geographical – bottlenecks (see Box 4) are the main explanation why those countries are unable to fully exploit and benefit from their access to world markets. This is, moreover, underscored by their inability to fully benefit from duty- or quota-free market access under a range of OECD countries’ preferential arrangements (although restrictive rules of origin are also a hindering factor). In other words, their poor performance is the consequence of their ‘underdevelopment.’ (UNCTAD, 2004)

18. In addition, most significant trade reforms took place in the early 1990s and the process of building internationally competitive economies takes time, particularly in low-income countries which are still disproportionately burdened with rigidities that hinder the transfer of resources from one sector to another, and that increase both the cost and pace of adjustments. Limited access to financial services, monopolistic distributional structures, as well as barriers to entry and exit of firms all hamper the expansion of new sectors and prolong the time that resources such as labour and capital lie idle.

19. However, as the events of the last decade (not to mention the recent few months) have shown us, unpredictable adjustment pressures in the short-run often come from factors other than trade liberalisation, such as movements in commodity prices and major shifts in exchange rates. Rapid technological progress has also become an increasingly important source of adjustment pressures. Hence, it is crucial that countries become more flexible and able to engage in new economic activities or expand existing ones if they were to benefit from integrating into the world economy.

#### **4. What Aid for Trade can do**

20. Trade is an important tool to achieve self-sustaining growth, and is an “often powerful weapon in the arsenal of policies that we can deploy to fight poverty.” (Bhagwati, 2004) However, as acknowledged in the WTO Hong Kong Ministerial Declaration, trade liberalisation and enhanced market access have not been sufficient in many low-income countries to expand trade, let alone to ensure that its benefits reach the poor. Clearly improved market access without the capacity to trade is of little use.

21. Helping those countries to build that capacity and integrate into the world economy is the *raison d'être* of Aid for Trade. As world markets become increasingly integrated, the opportunity cost of

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7. A further argument for trade integration of South-South goods and services can be made under both inward- and outward-oriented development paradigms. Under the former, South-South trade is viewed as an alternative to North-South trade that would enable the South to reduce its dependence on the technology-dominated markets of the North. Under the outward-oriented development paradigm, South-South trade integration is seen as complementary to North-South trade as Southern markets, with their high growth potential, may offer attractive export opportunities. (Otsubo, 1998)

marginalisation increases – as do the physical, human, social and institutional infrastructure needs for a successful integration. More and better Aid for Trade has a crucial role to play in helping poor countries implement coherent development strategies that include the investments and reforms necessary to enhance their supply-side capacity, and to foster the linkages and spill-overs necessary to ensuring that the benefits of export growth also reach poor groups and poor regions, for example, in the form of employment opportunities.

22. In the preamble of the agreement that established the WTO, the international community placed explicit priority on “raising standards of living” and on “sustainable development” among the objectives of this new multilateral trade body. This aspiration led to the launch of the Doha Development Agenda and subsequently provided a mandate through the Hong Kong Ministerial Declaration to operationalise Aid for Trade in order to enhance growth prospects and reduce poverty in developing countries, as well as complement multilateral trade reforms and distribute the global benefits more equitably across and within developing countries. (WTO, 2005)

23. The fundamental aim of the Aid for Trade initiative is to help low-income countries overcome structural limitations and weak capacities on many fronts that undermine their ability to produce, compete and fully benefit from emerging trade and investment opportunities. Aid for Trade is envisaged to provide a framework in which to connect the wide-ranging assistance activities (from training negotiators to building roads) within a coherent trade and development strategy. The WTO Task Force on Aid for Trade defined Aid for Trade broadly enough to reflect the diverse trade needs identified by developing countries. More specifically, the Task Force agreed that projects and programmes should be considered as Aid for Trade if those activities had been identified as trade-related development priorities in partner countries’ national development strategies.

24. The challenge for an aid agency providing trade-related assistance is to ensure that trade expands and generates pro-poor growth. Since the incidence of poverty is country-specific, any pro-poor policy, including trade policy, must first identify who the poor are, where they live; how they earn their livelihoods; and, what constrains them from participating in growth. Next, the ability of poor women and men to participate in trade depends on several factors, including: *i*) how much of the trade-induced growth occurs in sectors where a large number of the poor are economically active; *ii*) how much of that growth translates into job creation and wage increase; *iii*) how much growth trickles down to other sectors that can absorb excess labour; and, *iv*) how well the poor are equipped (in terms of human, economic and financial assets) to take advantage of the new job opportunities resulting from trade (see Box 3).

### **Box 3. How trade affects household poverty**

There are three main channels through which trade can have a direct impact on poverty (Winters, 2002):

1. *How changes in border prices get translated into the prices actually faced by the poor.* This depends on (i) the competitive structure of the distribution sector; (ii) the way in which government institutions, such as marketing organisations, operate, and (iii) the size of the tradeable sector in the domestic economy.
2. *How trade impacts on profits, employment and wage levels.* There are two opposite ways in which this might occur. If wages are flexible and available labour is fully employed, then price changes caused by trade expansion will be reflected in wage changes, with employment staying the same. Alternatively, if there is a large pool of workers who move in and out of a job when circumstances change, then trade expansion will change the employment level. In reality, both effects occur simultaneously, with the balance between them depending on the relative flexibility of wage levels and labour markets.
3. *How trade changes government revenue and expenditure.* The key lessons are that (i) expansion does not have to lead to a reduction in revenues if the tariff peaks and exemptions are tackled at the same time, and (ii) short falls in tariff revenues should be compensated by more broad-based and less distortive replacement taxes, such as those based on value added. More generally, sound macroeconomic policies are far more important for maintaining social expenditure than relying on tariffs.

Source: Winters (2002)

25. McCulloch, Winters and Cireca (2001) identify four issues that are fundamental to the impact of trade expansion on the poor:

- 1) *The need for a balanced growth strategy.* The weight of evidence is that openness to trade is good for economic growth and that, depending on its pace and pattern, growth is good for the poor. For its full benefits, trade expansion should be accompanied by sound policies in areas such as the rule of law, macroeconomic stability, competition policy, education and governance; otherwise it will fail to generate the investment and productive improvement required for growth.
- 2) *Supply-side response.* The ability of the poor to respond to new opportunities will be influenced by location and demographic structure, gender relations, health status, and assets of the poor. But for the long-term benefits to accrue in terms of poverty alleviation, reasonable supply-side responses are essential.
- 3) *Vulnerability of the poor.* The magnitude of income changes the poor experience following trade expansion depends in part on its ability to adjust to a new set of prices (and on incentives more generally). In turn, this depends on a number of factors, some of which can be influenced by complementary government policies.
- 4) *Adjustment costs.* Much of the criticism of trade expansion concerns adjustment costs. Empirical evidence suggests that the size and impact of adjustment costs are usually not large. Nevertheless, opening trade does force the government to focus its anti-poverty programmes on those with the least capacity to cope with adjustment costs, while at the same time, ensuring that such programmes do not undermine the incentives to adjust. It is thus important to ensure social expenditure levels and appropriate targeting of policies.

26. Moreover, in terms of policy instruments, those drivers can be divided into three main categories:

- a) Policies to overcome supply-side constraints and build productive capacity (*e.g.* reducing trade costs, improving transport links and access to electricity, improving the business environment and/or access to credit, etc.).
- b) Policies to provide opportunities to the poor to share in the gains from trade (*e.g.* access to non-traditional markets, extension services, micro-credit, etc.). Many of those policies are common to the promotion of pro-poor growth in general.
- c) Policies to mitigate the costs of adjustment (*e.g.* social safety nets, vocational training, etc.).

## 5. Increasing the benefits of trade

27. Many of the rigidities hampering the ability of low-income countries to expand their trade lie in behind-the-border measures and trade-related infrastructure. Transaction costs (trade facilitation, communication, transport and energy costs) tend to be systematically higher in developing countries. For example, although a large portion of Africa's trade is conducted using maritime transport, the freight costs remain high – total freight costs represent more than 10% of imported value, as compared to an average of 8.8% for all developing countries and 5.2% for developed countries. (UNCTAD, 1999) Some of those added costs are due to inefficient port services in the continent. Clark, Dollar and Micco (2004) estimate that inefficient ports are equivalent to being 60% farther away from markets for the average country and that a relative decrease in the inefficiencies associated with maritime transport from the 25th to 75th percentiles would lead to an increase in bilateral trade of around 25%.

28. Bora, Bouet and Roy (2007), on the other hand, present a gravity model showing that Africa's trade under-performance is driven by poor trade-related infrastructure (*e.g.* air and road transportation and communications), while GDP, geographic distance and access to foreign markets do not fully explain Africa's low trade performance. The authors conclude that interventions to improve both the level and quality of infrastructure could yield higher returns. Similarly, Limao and Venables (2001) argue that the quality of infrastructure is an important determinant of transport costs, and show that poor infrastructure accounts for more than 40% (and up to 60% for landlocked) of predicted transport costs (see Box 4).

### Box 4. Connecting landlocked countries: the need for infrastructure

Countries differ in their trade and growth potential. The Commission for Africa (2005) identifies geography as one of the two root causes of Africa's poor development performance (the other being governance). The Commission points out that these landlocked countries, where more than a quarter of Africa's total population live, face a substantial competitive disadvantage and therefore are much more likely to remain poor. For instance, transport costs are 50% higher and trade volumes 50% lower than in similar coastal countries. It is also said that being landlocked is equivalent to being located 10,000 km farther away from markets. (Clark, Dollar and Micco, 2004) Due to their lack of access to infrastructure, a higher proportion of people suffer from undernourishment than their peers in coastal countries. Worst still, if the neighbouring countries are also poor, their landlocked-ness even becomes a poverty trap. (Collier, 2007).

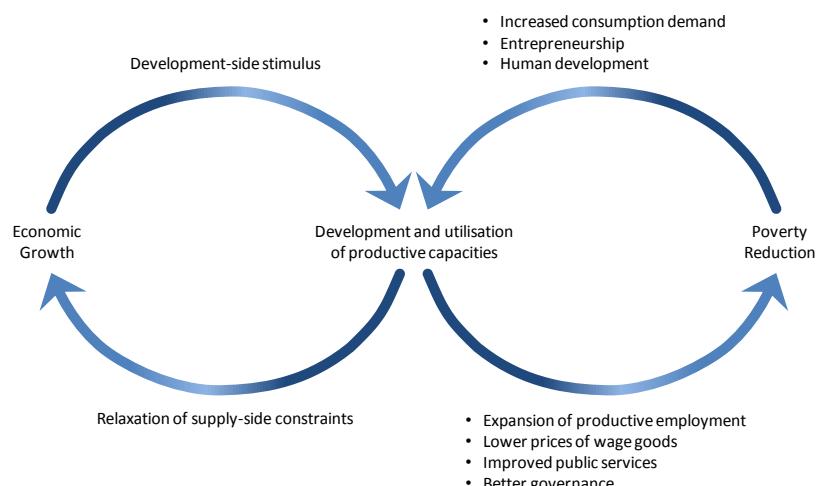
Reliable and affordable infrastructure reduces the cost of doing business. It helps to connect poor people to the growth process by improving their access to growth poles and their mobility. There is evidence that increased access to infrastructure contributed to lowering of income inequality. (Calederon, 2004) For landlocked countries, it is imperative for growth and poverty reduction to improve the infrastructure. The Commission recommends that Africa needs an additional USD 20 billion investment each year in infrastructure. This should support the continent's regional, national, urban and rural infrastructure priorities – ranging from rural roads, power plants to ICT and other economic infrastructure needed to support greater integration of sub-Saharan Africa, and to enable African countries to break into thriving world markets.

## 5.1 Building productive capacities

29. In low-income countries, export-led growth strategies can often end up exclusionary. That is why more balanced development strategies are needed to address the barriers between the domestic and export sectors which often explain diversification failures in those countries. The only way to achieve a sustainable supply-side response and concomitant expansion of productive employment opportunities is through the development of productive capacities, *i.e.* productive resources, entrepreneurial capabilities and production linkages. Together, such capacities determine the ability of a country to produce goods and services, and enable it to grow and develop. The core processes through which productive capacities are built are capital accumulation, technological progress and structural adjustment. (UNCTAD, 2006a)

30. The importance of developing productive capacities for trade expansion and poverty reduction is evident in the experience of developing countries which have managed to achieve sustained and substantial poverty reduction over the last three decades. The key links between productive capacities, economic growth and poverty reduction are presented in Figure 4. On the left side, there is the virtuous circle between development of productive capacities and economic growth, through the relaxation of supply-side constraints and the stimulation of demand. On the right side, there are further feedback loops between development of productive capacities and poverty reduction through: *i*) productive employment; *ii*) lowering of prices; *iii*) increased government revenue and services; and *iv*) better governance. Furthermore, the degree of productive capacity building is strongly influenced by the degree of openness and the quality of institutions (UNCTAD, 2006a).

**Figure 4. Relationship between economic growth, productive capacities and poverty reduction**



Source: UNCATD (2006a)

31. The existence of an open trade regime does not imply that the domestic economy is free of distortions. On the contrary, domestic market and government failures may hinder any spill-overs from trade reform. For example, in many low-income countries, the informal sector represents a very high proportion of the domestic economy and cross-border trade. While informal sectors are fully unregulated and can sometimes thrive because of that freedom, informal enterprises' growth and capacity to adopt technology and increase productivity are severely constrained by their inability to enter into credible arm-length contracts – a key feature of legal cross-border trade. Thus, in economies where the costs of formalisation are very high, the benefits of trade are likely to remain confined to the formal sector and exclude potentially a large segment of the population.

## **6. Pro-poor growth through trade**

32. There is no single recipe for (or a model of) a successful transition to the path of rapid economic growth that has sizable and sustainable impact on poverty reduction. Institutions that work in one country may not necessarily work in another. Hence, developing countries need to pursue and be ready to experiment with different types of policies, institutional designs and growth strategies (both pace and pattern). Rodrik (2003) identifies a trinity of ‘fundamental principles’ for economic policy: *markets* that promote competition and allocate resources efficiently; *institutions* that guarantee rights to property and integrity of business transactions, without which markets will go ‘missing’; and *macroeconomic stability* to instil confidence in future economic prospects, and hence encourage investment for further growth. Individually they are not sufficient to induce growth but rather they are needed in combination.

33. Growth in general is rather a messy process and no one should expect it to be unconditionally fair to all by design. That is why governments need policies for pro-poor growth and to reach those sub-groups of people to whom such growth does not reach. To make growth more pro-poor, OECD (2006a) highlights three key messages:

- Rapid and sustained poverty reduction requires pro-poor growth, *i.e.* the pace and pattern of growth that enhances the ability of poor women and men to participate in, contribute to and benefit from growth. Policies therefore need to promote both the pace of economic growth and its pattern, *i.e.* the extent to which the poor participate in growth as both agents and beneficiaries, as these are interlinked and both are critical for long-term growth and sustained poverty reduction.
- Policies to tackle the multiple dimensions of poverty, including the cross-cutting dimensions of gender and environment, are mutually reinforcing and should go hand in hand. Progress in one dimension will be accelerated by progress in others. In tackling poverty, perceptions of policy dichotomies have been misplaced. Policy trade-offs do exist but can be better managed.
- Empowering the poor is essential for bringing about the policies and investments needed to promote pro-poor growth and address the multiple dimensions of poverty. To achieve this, the state and its policy making processes need to be open, transparent and accountable to the interests of the poor. Policies and resources need to help expand the economic activities of the poor.

### **6.1 Connecting the poor to markets**

34. Most country case studies commonly identify the role of markets as a critical factor in determining the poverty impacts of trade. Where conditions of the poor have improved this has usually been associated with better performance of and access to markets. Where those conditions worsened faulty markets are usually to blame and, in extreme cases, the problem is the complete absence of a market. In Madagascar, for instance, poor households are almost completely disconnected from the few rudimentary markets that exist due to a lack of infrastructure. (Hoekman and Olarreaga, 2007)

35. More than half the population in developing countries and more than three-quarters of the poor live in rural areas where agriculture typically constitutes 50 to 90% of household income. However, the lives of poor men and women who are located in remotest regions are especially disconnected from the market. They typically work on small, rain-fed farms, growing stable grains partly for their own consumption. The development of efficient agricultural markets could, thus, have a large impact on the economic opportunities of rural households (IFPRI, 2007).

36. Connecting poor farmers to markets and enabling them to sell their crops provides significant benefits. When various physical and institutional constraints are removed, farmers can earn more by

specialising in crops for which they have a comparative advantage and purchase commodities that are relatively costly for them to grow. Indeed, those who produce mainly for their own consumption are the poorest, whereas those who are well integrated into markets and specialise in a smaller number of crops tend to be better off. With rapid evolution of food-marketing systems in developing countries, identifying the “best” crops for farmers to grow based on their agro-climatic conditions and proximity to markets is improbable. Farmers themselves must have better incentives and access to information to make such decisions. Rather, what is needed is a set of marketing policies and institutions that connect farmers to markets by reducing their marketing costs and risks (IFPRI, 2007).

37. Hertel and Winters (2005) confirm that the degree to which border price changes are transmitted within countries strongly affects their impact on households. Efforts to boost productivity through better extension services, coupled with improved access to marketing and distribution networks, would help rural farmers respond more fully and derive bigger income gains. Similarly, this analysis strongly confirms the importance of better market integration and investment in rural infrastructure to help reduce transport and energy costs thereby better transmitting the opportunities created by market opening to those regions and maximise potential gains against poverty.

38. The need for integrating local, national and regional economies as a basis for successful globalisation is evident, particularly by linking rural famers to markets and connecting them to deeper and more competitive value chains. Today, food and other agricultural products are sourced globally as much as manufactured products and the expanding markets for agro-food products is opening up new opportunities for developing countries (see Box 5). Participation in and linking up to regional or global agro-food value chains allow developing country producers to overcome the limits imposed by their small domestic markets. It provides them access to more vibrant markets, allowing them to upgrade their production processes and improve the quality and value-added of their products.

#### **Box 5. The case of the Zambian agro-processing sector**

Zambia shows that a more efficient agriculture sector coupled with strong growth can trigger development in the off-farm sector that has a base in agriculture such as agro-processing industries through production linkages as well as expenditure linkages associated with higher agriculture revenue.

The government of Zambia gives the highest priority to agricultural development and private sector-led growth through diversification and trade expansion. Although the strong growth performance of the recent years has been mainly attributed to its booming mining sector (copper is the country's single largest foreign exchange earner), agriculture is the most dynamic component of Zambia's export economy and is the main driver of export diversification. The sector's share of total export rose from less than 5% in the 1970s to around 20% in the beginning of the 2000s. This sector also absorbs about 70% of the labour force and hence is the main source of income and employment for the majority of Zambians, in particular, the poor. Additionally, this sector is characterised by high participation of women in labour force.

The agro-processing sector enjoyed a reasonably good market in Zambia with a notably indigenous production structure whereby the industries used a significantly high proportion of local raw materials. Since opening up to foreign trade, the sector has recorded significant growth output and employment. In addition to its contribution to national income and employment, agro-processing has the potential to increase income and access to food for the rural poor, who largely depend on agriculture for their livelihoods. This is achieved through the creating of small-scale processing businesses that can be carried out at homes and do not require huge investment. Through such ‘spill-over’ transmission mechanism, agro-processing can potentially impact household poverty in a sustainable manner.

Source: Seshamani (2006); Bonaglia, Fukasaku and Hayashikawa (2006)

## **6.2 Trade and inequality**

39. The poor are not a homogenous group and the heterogeneity in outcomes means that some sub-groups of people, including women and ethnic or religious minorities, may face tougher challenges to participate in the economic process.<sup>8</sup> It is thus important to keep in mind the heterogeneity of responses by different groups among the poor, between men and women, and spatial differences including between the urban and rural poor. This underscores the need for carefully targeted measures to promote adaptation to ensure that the benefits of new opportunities presented by trade are as widely distributed as possible, and that vulnerable populations are protected from adjustment costs as much as possible (see Box 6).

40. Where there is wide-spread poverty and most of the population live at or below income levels sufficient to meet their basic needs, a purely export-led growth strategy is unlikely to deliver on its own an inclusive growth process that has strong linkages to the domestic economy and expands economic opportunities that the poor can take up. Moreover, even if growth helps reduce levels of absolute poverty, inequality may still increase. For example, a World Bank study (2005) confirmed that during the 1990s, countries with rapid economic growth and trade liberalisation achieved absolute poverty alleviation, but also tended to experience increased inequality.<sup>9</sup> UNDP (2005) finds that uneven distribution of the costs and benefits of trade liberalisation across and within countries has resulted in an uneven pattern of integration.

41. Furthermore, not only increased inequality weakens the trade-driven growth elasticity of poverty reduction (*i.e.* the extent to which a unit of export growth reduces poverty), it also affects the sustainability of policy reform. That is, due to rising inequality in incomes, assets and opportunities the people who are forced to bear the brunt of adjustment costs may blame governments for what they see as weak outcomes from painful reforms, making it much more difficult for governments to gain public support for further reforms. A more balanced strategy – that allows for trade openness in varying degrees (for different kinds of goods and services with appropriate timing) and that prioritises human development outcomes – is required for a more virtuous trade-poverty *nexus*. (UNDP, 2003; UNCTAD, 2004) The growth experience shows that rising inequality is not an inevitable consequence of the growth process, as long as there is a mix of policies that addresses both growth and distributional objectives, strengthens empowerment, and deals with gender and other biases (*e.g.* race, caste, disability or religion).

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8. The January 2008 issue of *Poverty in Focus* provides an overview of the issues surrounding gender equality and pro-poor growth and brings together recent work by academic researchers on this important topic.

9. However, evidence on the effects of trade and growth on inequality is mixed. For instance, IMF (2007) analysis on globalisation and inequality found that trade openness actually reduces income inequality, both in developed and developing countries, when trade effects are isolated from other growth drivers, such as technological progress. Whereas, Kremer and Maskin (2007) describes how increased trade resulting from globalisation tends to benefit elites in both rich and poor countries and thus increase income inequalities in both country categories. Other recent work on the relationship between globalisation, inequality and development include Nissanke and Thorbecke (2007); Mamoon (2007); and Goldberg and Pavcnik (2007).

#### **Box 6. Women and trade: the case of the Cambodian garment industry**

The impact of trade expansion on the distribution of income and employment differs between men and women. Women are more vulnerable to chronic poverty because of gender differences in the distribution of income and through lack of access to productive assets like land and credit. Furthermore, within households, men may constrain women's employment and control the income women earn. Inequalities between men and women in accessing opportunities, or 'resources, rights and voice', are thus closely linked to women's empowerment, as well as children's well-being. (Morrison *et al.*, 2007)

Evidently, trade has very different impacts on women and men due to such gender relations but, in practice, the impacts of trade are felt by all individual men and women as fluctuations in prices (and hence availability of goods) and through changes in output (what they produce, how and under what conditions). There have been increased employment opportunities for women in non-traditional agriculture such as cut flowers, in clothing and textile industries, and also in electronics-oriented Export Processing Zones (EPZs) and services sectors. Much of this increase is concentrated in export-oriented industries where electronic components are assembled, textiles processed, and garments and shoes produced. (Sexton, Nair and Kirbat, 2004) Paid employment can improve women's autonomy as well as their economic and social status. It can also shift power relations between women and men, including at household level, and can improve women's well-being, negotiating power and overall status.

For example, a study by Neak and Yem (2006) describes how the Cambodian garment industry has been a major contributor in boosting the country's economic growth and reducing poverty. The industry plays a vital role in earning foreign exchange. The share of garments in total merchandise exports rose from a mere 6% in 1995 to 76% in 2005, earning USD 2.2 billion. The impact on income from this sector goes far beyond the workers employed in this sector and it is estimated that at least one million people benefited through direct and indirect employment and income, including remittances. The garment industry is particularly significant in empowering women. Young female workers make up as much as 90% of the labour force in the garments industry, which represents about 20% of the country's total female workforce. They typically have little or no education and come from poor rural regions. (Neak and Yem, 2006)

More significantly, the study finds that, over the years, employment in the garments industry has helped to break down the restrictive social norms and attitudes that only men should be involved in economic and union activities. Indirectly women play an even more important role through their support for poor family members in rural areas. A garment worker received an average monthly wage of USD 60 in 2004. They sent about half of their monthly wages to their families back home, typically supporting another four or five members. These remittances are used to buy food and support family healthcare and education, thus, reducing significantly the incidence of extreme poverty. (Neak and Yem, 2006)

In short, having a daughter working in the garment industry is considered as one of the prime factors allowing rural families to move out of poverty. Nevertheless, risks remain as the garment industry can easily be relocated to other countries and there are limited job opportunities in other sorts of the formal sector for the unskilled. Furthermore, workers in smaller garment factories remain susceptible to health and safety risks due to frequent overtime to increase their income. (Neak and Yem, 2006)

## **7. Mitigating the costs of adjustments**

42. The largest gains from trade liberalisation come from the process of transferring resources to more productive uses. Still, while trade reform enables fast growth in export industries, reallocation of resources (capital and labour) also often means closures of firms and job losses in some sectors. Indeed, there is broad agreement that while trade integration leads to long-term welfare and efficiency gains, it can also involve costly short-run macroeconomic adjustment, with some people "winning" and others "losing." Jobs created as a result of trade expansion are at first concentrated in the export sector but in some cases – particularly with respect to certain extractive sectors – the export sector is only weakly linked to the rest of the mostly informal economy, hampering any significant spill-over effect.

43. Logic dictates that identifying which groups are likely to suffer short-term harm can help in designing appropriate safety nets beforehand. The impact of trade integration on a particular poor person

depends heavily on which sector that person was initially working in and their consumption basket. Changes in wages and employment are one key mechanism by which external trade translates into poverty reduction impacts. Oftentimes, changes in consumption prices will affect different groups of poor differently. For example, food prices increases are generally beneficial for the agro-rural poor who at the very least will see their earning opportunities expand and negative for the urban poor who spend a very large proportion of their income on food and are directly made worse off by any increase in price.<sup>10</sup>

44. In macro terms, adjustment costs may be greater if the economy was originally highly protected, but such costs are typically small compared to the benefits of trade liberalisation and are also typically short-term. (Winters, McCulloch and McKay, 2004) But when the poor are at the losing end of integration, they are less capable of coping with adjustment, and the effects can be long lasting, particularly when family investments in health and education are affected. In such situations, what is needed are social protection policies that facilitate the transition following trade reform and provide security and insurance against adverse events and, more critically, that help the poor take required adjustments. Such social protection will help minimise those short-term transition costs and maximise the potential for long-term gains for the poor. However, one needs to examine social protection policies to ensure that they do not become disincentives to adjustment – though there are studies with evidence suggesting that this is not generally an issue for concern (see Box 7).

#### **Box 7. The case of social cash transfers in South Africa**

According to Samson (2008), studies – using panel labour force surveys tracking social grant recipients in South Africa over time – have found that workers in households receiving social cash transfers (grants) look for work “more intensively and extensively” and as a result find new jobs more successfully than do workers in comparably poor households that do not receive such grants. Samson also explains that social grants are likely to mitigate social risks and relax liquidity constraints on poor households, thereby encouraging migration and employment search. Similar impacts and anecdotal evidence were also said to be found in countries such as Brazil, Mexico, Kenya, Namibia and Zambia.

45. Furthermore, trade policy liberalisation reforms will not by themselves automatically lead to poverty reduction and might even be subject to policy reversals without necessary complementary reforms. The 2005 OECD Trade and Structural Adjustment Project (TASAP) already identified that the most successful trade reforms had been accompanied by some form of assistance for those bearing the brunt of the adjustment. With some care, targeted assistance – a much more pragmatic solution for low-income countries than general assistance measures such as social security – can be effective and equitable. For effectiveness, targeted assistance schemes need to be: *i*) time-bound with a clear exit strategy; *ii*) decoupled from production; *iii*) aimed at re-employing displaced workers; an *iv*) compatible with general safety net arrangements (if existing); and *v*) transparent and accountable (OECD, 2005b).

46. Harrison (2006) also argues that further attention on properly identifying which types of policies should accompany trade reforms and improving the understanding of how to design appropriate social safety nets are key to secure the benefits of trade. For example, ILO/WTO (2007) finds that trade reforms introduced in conjunction with labour market programmes are more likely to have significant positive effects on both growth and employment (thus on the overall poverty impact).

47. Mauritius is a good example of a small developing country that has explicitly integrated in its Aid for Trade strategy a programme to provide vocational training to displaced workers affected by the

10. The winners and losers are not always distinct groups and sometimes the same group of people could win in some ways and lose in some other ways, and the net result may not be readily observable.

economic restructuring. Mauritius embarked on a radical restructuring of its economy by transforming its traditional sectors (textiles and sugar), promoting growth in existing sectors like financial services, and developing higher value-added industries in such areas as ICT. This was made possible because its government was fully aware that both labour and trade reforms were needed to complement each other to minimise the adjustment costs of the reform process and maximise its sustainability.

48. Trade development strategies should not be designed in isolation from other economic development policies, especially, social policies. Clearly, a robust economy requires strong economic agents, ones with the capabilities to be productive and entrepreneurial. That, in turn, requires better educated and healthy populations because human capital is essential to economic growth and development. Hence, adequate provision of basic education and healthcare services can generate positive spill-overs and improve economic and social well-being of the country. For instance, policies that provide wider access to education have been found to stimulate growth and reduce inequality at the same time (ILO/WTO, 2007).

49. Improved education can help fill expanding sectors' need for better educated or skilled workers, diversify production into higher value-added products, and should be made a cornerstone of the government's pro-poor policy and strategy. Improvements in education are especially important, given the dismal state of education in many poor regions. Moreover, education plays a key role in promoting labour productivity and mobility. A recent study found that, in the case of China, greater educational attainment strongly facilitates mobility from farm to non-farm sectors, often a pathway out of poverty. One additional year of schooling was found to boost a worker's chance of finding off-farm employment by 14% (Zhang, Huang and Rozelle, 2002).

50. Other complementary policies of particular importance include access to better healthcare services, stronger property rights, access to credit for investing in technology improvements, access to information, and the ability to move between contracting/expanding sectors. These policies are needed to ensure that benefits of trade are shared across the population. Strengthening the capacity of developing countries to design and implement such policies is critical for enabling them to cope better with the social impact of trade reforms, as well as helping to increase popular support for the reforms themselves (ILO/WTO, 2007).

## **8. Global approaches – local solutions**

51. Trade opportunities and constraints faced by countries depend on initial conditions that have been shaped by history, endowments, administrative capabilities, and a host of other factors. As such, designing pro-poor trade strategies is dependent on identifying a selective and sequential approach that accounts for country-specific circumstances. How trade openness affects poverty in any individual country depends on the country's specific circumstances, including its geographical position and on the situation of its poor citizens. Trade openness needs to be broad based across sectors and regions and inclusive of the large part of the work force that poor men and women make up. Clearly, this calls for the need for 'localised' solutions that are tailored to specific national priorities and contexts, including the kinds of complementary policies that can be adopted along with trade reform to ensure greater gains for the poor.

52. A study by CUTS International (2008) on trade-development-poverty linkages concludes that the most significant feature is that the same set of policies produces dramatically different results in the different country case studies. It identifies that the differing outcomes are due to: varying physical and geographical characteristics of the countries; the nature of the implementation of these policy measures; the capacity and quality of institutions under which the reforms are implemented; and the political and social environment. The complex interaction of policy reforms and the country's existing structural attributes determine the overall outcomes that are beyond the predictions of simplified theoretical constructs (CUTS, 2008).

53. It is widely recognised today that a ‘one-size-fits-all’ approach is not conducive to development and will eventually fail to deliver results. While the ingredients are common across different growth experiences, the recipes need to be very country specific. But it is also important to note that successful cases of trade expansion have done so under regimes that did not disadvantage export industries and by following the comparative advantages in their economic development (Michalopoulos, 2003; Lin, 2007).

## 9. Conclusions

54. Trade is a central part of the economic growth and poverty reduction agenda. To this end, Aid for Trade interlocks aid and trade into 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 broader development community acknowledges 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 poor people’s constraints to taking up the new economic opportunities arising from expanding regional and global markets.

55. In order to better balance trade and growth with sustainable development benefits, it is essential to pay close attention to the differential impact of trade on different groups from the angles of employment (export-oriented and import-competing), gender (poor women and men) and geography (including rural and urban poor). Export-oriented trade policy interventions, if they are to have a greater pro-poor impact, need to consider the country-specific profile of the poor and the many roles they play as consumers, workers and producers: who and where the poor live; how they earn their livelihoods; and, what constrains them from participating more in growth are key questions for policy makers to ask and answer. Such country-level assessments of the impact of policy interventions on the poor will help devise responses that will better translate trade-induced growth into poverty reduction.

56. Trade is not a *panacea* for economic development. For the poor to share in the gains from integration, other complementary policies to help connect them up to the economic process need to be in place. These include policies aimed at enhancing the productive capacity of the whole economy and better integrating into domestic, regional and global markets, thus boosting the incomes of the poor. Depending on the country context, doing so could require further investments in human capital (*e.g.* education, health and nutrition) and rural infrastructure, access to credit and technical assistance (agricultural extension services for poor farmers), as well as safety nets and policies to promote macroeconomic stability. Such policies, which reduce the risk and vulnerability of poor men and women, help them adjust to structural changes and take advantage of opportunities created through further market opening.

57. Aid for Trade, delivered in conjunction with effective complementary policies that reduce the risk and vulnerability of the poor, aims to help developing countries translate opportunities to trade into economic growth and poverty reduction. Finally, to ensure greater coherence between trade policies and development assistance, it is paramount that the trade and development communities work together more closely and coherently so as to enable developing countries to reap more fully the benefits from participating in global trade.

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