Realising the Developmental Benefits of Trade Through a Global Partnership

Introduction

The benefits of trade for economic development and poverty alleviation can be better realised if the process of trade liberalisation is couched in a partnership which provides for complementary foreign aid and investment. This advocacy note explains how.

Trade as an Engine of Economic Development and Poverty Alleviation

Trade can be a powerful engine for economic development and poverty alleviation. It is for this reason that trade liberalisation is advocated for low income countries burdened by a high incidence of poverty. This is a valid and useful prescription because of the following reasons:

Exposure of an economy to international trade implies higher/lower prices facing producers/consumers - in other words, more profitable production and cheaper consumption. Apart from households, producers too consume – in their case the items of consumption are inputs into production such as raw material, machinery and equipment etc. Thus, trade implies lower costs of production as well.

The result is of course a boost to the country's income which in turn augments saving and consequently, investment and economic growth. In most cases, such economic growth can benefit poverty alleviation through channels such as greater development expenditure financed through tax collections and a greater demand for labour. Downward trends in prices of items of household consumption through cheap imports might also have a beneficial impact on poor people.

Common Misperceptions about the Linkages among Trade, Development and Poverty Alleviation

The prescription of trade liberalisation for breaking out of the vicious circle of poverty and low income, though appropriate, is incomplete. Trade is part of the cure for low income countries – not the entire cure. It needs to be backed up by adequate preparation detailed below. And equally importantly, the health of economies, just like that of individuals, can be compromised by incomplete prescriptions.

Anti-trade activists often showcase failed cases of trade liberalisation, mostly in Africa, to argue that trade is not only not the beneficial engine that it is made out to be but is positively inimical to the interests of low income countries. But such showcasing is a misrepresentation of evidence – the perceived failure of trade liberalisation stems not from its inadequacy as a stimulant of development but because of inadequate preparation and the consequent absence of complementary factors.

To again draw an analogy with medicine, life saving drugs such as antibiotics have to be accompanied by catalysing and protective potions of vitamins, iron etc. The latter complement the former by boosting immunity and softening side effects. Life saving hard medicine continues to be used despite its side effects. A good physician does not avoid the use of such medicine but ensures that it is administered in tandem with protective and softer medicine. Similarly, a good policy maker does not avoid the use of trade liberalisation but buttresses it by emphasis on adequate preparation and the use of complementary measures. The next section elaborates on these complementary and preparatory measures.

Complementary Measures: Supply Side Capacity, Trade Facilitation and Social Safety Nets

An open trade regime is useful as long as cheap imports, which bring down the cost of consumption or facilitate greater variety in consumption, are also accompanied by adequate revenues through exports. A country which is handicapped on the supply side through poor infrastructure or inadequate human capital will definitely not be able to meet the increased import bills that might result from liberalisation.

This implies that adequacy of supply side capacity, as mentioned above, must be ensured before a country liberalises its trade. Otherwise, outflows through payments for imports will overwhelm export earnings. The problem of chronic indebtedness is as real here as it is in the case of a person who lives beyond his means.

The importance of supply side capacity can be gauged from some of the statistics highlighted by the CUTS project on Trade- Development–Poverty Linkages. For example (see Table), India achieved an annual average growth rate of GDP of around 6 percent in 1995-2002 -- much higher than that of Nepal (4 percent) and Kenya (2 percent) even though it was much less open than these economies during this period i.e. its average tariff rate was much higher. Outcomes for poverty alleviation are similar: India in the lead followed by Nepal, and Kenya bringing up the rear with escalation of poverty in the period under consideration (see the last column in the table provided below).

It is important to realise that all three countries have been liberalising in recent times. However, the success of liberalisation is not determined by its extent – on the contrary, it is India which is the most closed of these three economies which has registered the highest growth by far as well as the fastest pace of poverty alleviation.

The differences in liberalisation outcomes among the three countries are to a large extent explained by differences in supply side capacity. The country paper for Nepal written for the mentioned project indicates that it continues to be plagued by low levels of human capital and inadequate infrastructure apart from poor governance. The same factors, according to the country paper for Kenya, continue to impede the Kenyan developmental effort. India on the other hand has managed to upgrade some of its infrastructure in the period after 1990 – for instance, in telecommunications, civil aviation and ports. Its human capital continues to be superior to that of the other two, allowing it to capture the potential benefits of liberalisation.

Table: Key Trade and Development Outcomes – India, Nepal and Kenya

	Average Tariff rate in 2001 (percent)	Average Annual growth rate in 1995-2001 (percent)	Changes in poverty ratio expressed in percent	Rate of poverty decline (percentage points per year)
India	32	6	37.3-27.1 (1993-99)	1.7
Nepal	14	4	41.76-30.85 (1995-2003)	1.36
Kenya	18	2	44.78-52.32 (1992-97)	-1.51

Note: The period for which poverty change is indicated is mentioned in brackets

Alleviation of supply side constraints through development of infrastructure and human capital is not always enough for successful liberalisation. Trade facilitation and regulatory measures are equally important. Economical transport of goods from factory to port and their handling at ports at reasonable cost are necessary for a country's exports to be competitive. Similarly, for cross-border trade transit should be both fast and cheap.

Such factors also crucially determine the cost of imported inputs borne by producers. Thus, facilities for trade facilitation are important determinants of the volumes of exports and imported inputs as well as the welfare benefits from international trade. Sometimes anticompetitive practices also result in higher costs for both exports and imports. Inadequate progress on these fronts has curbed the success of trade liberalisation and export promotion in many African countries.

Trade liberalisation also necessitates economic adjustment. Import substituting sectors contract with liberalisation while sectors producing exportables have the opportunity to expand. Labour displaced by such contraction has to be retrained and made suitable for other jobs. The ideal candidates in this regard are vacancies created through the expansion of sectors producing exportables. In other words, facilities for retraining and rehabilitation have to be adequate.

This is not all. While trade openness increases opportunities for economic development it also implies that the economy is less immune to demand and supply shocks from the rest of the world. For example, increases in cotton yield in China might lead to a decrease in the international price of cotton. This will in turn have a dampening effect on the incomes of Indian cotton farmers. Such examples illustrate the importance of a social safety net which protects both producers and their employees from the adverse effect of economic shocks.

To summarise, trade liberalisation alone does not guarantee positive development outcomes -- it needs to be accompanied by adequate supply side capacity (infrastructure and human capital), good amenities for trade facilitation, effective regulatory regimes and social safety nets for displaced economic actors. Another factor – the ability to negotiate advantageous trade agreements – can be added to this list.

Ensuring Successful Trade Liberalisation through a Global Partnership for Development

The objective of furthering a *Global Partnership for Development* (GPD) constitutes Goal 8 in the Millennium Development Goals of the *United Nations Development Programme*. The GPD can be conceived as the entire rubric of interactions among national economies that can lead to economic development and poverty alleviation in low income countries.

Such interactions can be of three types – trade in goods and services, international aid and foreign direct investment. As mentioned before, mere trade liberalisation is not enough to bring about positive developmental outcomes.

Nevertheless, this advocacy note argues that the variety of facilities embedded in the GPD in its current state is quite adequate for ensuring successful trade liberalisation of low income economies. However, the magnitude as well as the targeting and absorption of different types of aid often leave a lot to be desired.

International aid at present is made up of three components – the six-agency managed Integrated Framework for Trade Related Technical Assistance (TRTA) to LDCs providing for studies to identify supply side constraints; the various aid for trade programmes run by developed countries and multilateral institutions for shoring up capacity on the supply side and in trade facilitation and negotiation; and finally the Trade Integration Mechanism of the International Monetary Fund to help economies overcome shocks originating externally.

It is important to note that the various operational aid programmes taken together provide all the facilities needed for successful trade liberalisation of a low income economy. However, while the structure of and diversity in aid provision mechanisms might be adequate, research indicates that the total amount of aid dispensed to developing countries is not. A systematic approach to prioritise aid across countries and within each country by type is also lacking.

The complementary role of international aid in ensuring successful trade liberalisation is often supplemented by foreign direct investment (FDI). This can be used to upgrade infrastructure in a developing country. FDI also results in transfer of knowledge, experience and know how. It also generates domestic productive capacities, generates employment and thus results in poverty alleviation

Conclusion

The Global Partnership for Development (GPD) is based on synergies among aid, international trade and foreign direct investment. The current state of the GPD provides enough scope for generating the complementary factors that can ensure successful trade liberalisation in low income economies. It is only the scale of the GPD as well as the ability of low income countries to absorb benefits generated through this partnership that has to be stepped up.