

How aid for trade helps reduce poverty

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Nearly five decades of international assistance to the developing countries hardly delivered the desired results—poverty reduction—owing both to demand and supply side constraints.

More recently, aid has hardly been a simple transfer of resources from the affluent to the deprived economies. Rather, it comes along with numerous conditional ties. These conditions explicitly or implicitly fulfill the interests of the donors; donors use aid to advance their values, their commercial interests, their cultural aspirations and their diplomatic and political objectives and not the developmental needs and priorities of developing countries.

Furthermore, such aid conditionality involves neo-liberal macroeconomic and trade prescriptions in the form of structural adjustment programmes that are more often a reflection of political and economic ideology of donors than of the economic development priorities of aid receiving countries.

Also, the distributive effects of trade liberalisation are diverse, not always pro-poor, and evidence from the 1990s on the relationship between trade reforms and poverty is to date mostly indirect. Even where trade policy has reduced poverty, there are still distributive issues, and this necessitates for fair and equitable trade. This is the crucial point for aid for trade that ensures additional, predictable and dedicated resources that successfully address the supply-side constraints—the capacity to produce goods and services competitively and the ability to get them to market at a reasonable cost—not usually covered by the conventional assistance.

Aid for trade has become a new mantra of the trade and development communities. Broadly, this refers to the provision of trade-related capacity building, trade-related infrastructure, supply-side capacities and, more generally, facilitation of trade-related adjustment, at least for the short and medium term. This initiative supports the capacity of developing countries to set their own trade policy agenda and participate fully in the multilateral trading system—negotiating trade rules, implementing commitments, and utilizing legal mechanisms like dispute settlement. This includes activities like training personnel; supporting institutional development; improving country-specific analyses; and technical cooperation on setting and meeting standards. Hence, the role of trade, as a powerful engine for sustainable economic growth and poverty reduction in least-developed and middle-income countries, is quite obvious.

Conventional wisdom on foreign aid suggests that trade liberalisation as a precondition for aid automatically leads to growth and development. However, most developing countries have been unable to fully benefit from trade owing to lack of trade surpluses, deficient knowledge of market access opportunities, lack of necessary exporting infrastructures, and inability to meet technical standards prevailing in high value markets.

As a result, the ultimate objective of aid to reduce poverty has largely remained under achieved, and thus deserves immediate concern and has serious implications for developing economies. Therefore, aid is essential to balance the realisation of poverty reduction and the costs of trade liberalisation.

There are mounting research works and emerging consensus on poverty, trade and development which suggest that one of the most viable options to reducing poverty, making the development aid effective, and realising the projected benefits of greater economic liberalisation is to provide assistance for strengthening trade capacity of those underdeveloped economies.

More precisely, the World Bank concludes that an important policy lesson from the 1990 reforms is that countries need to help the affected workers move out of shrinking (import-competing) sectors into expanding (exporting) sectors. For this to happen, a comprehensive aid for trade package is critically important. As a consequence, the World Bank and the IMF have jointly proposed an aid for trade package for provision of financial and technical assistance to developing countries to address supply side constraints and to assist them in copying the adjustment costs.

Furthermore, aid aimed at improving opportunities for trade has emerged vigorously in the trade and development communities.

Aid for trade strengthens the virtuous circle of trade-induced poverty reduction: increase in enhancement of trade-related capacity/global integration— increase in export— increase in production—increase in employment—increase in income—poverty reduction—diversification/increase in demand, and ultimately greater global integration, at the individual level.

Simultaneously, at the national level, increase in production will induce more investment in pro-poor and social activities leading to empowerment and capacity development, and ultimately poverty reduction. Indeed, from individual perspective, increase in income leads to empowerment and capacity development.

However, very little knowledge about the potential benefits and roles of aid for trade exists with the Nepali economists and policy makers, despite their emphasis on foreign aid, trade liberalisation and poverty reduction. There is a dearth of studies on the concept, various dimensions, roles, regulatory mechanisms, and potential benefits of aid for trade in Nepal, especially to reduce poverty.