CHAPTER 5
Trade liberalisation and the poor

Import liberalisation is used by the International Monetary Fund, the World Bank, and Northern governments as a standard for measuring the commitment of developing-country governments to economic reform and poverty reduction. Trade barriers are widely seen as an impediment to successful integration into global markets. The underlying presumption is that import liberalisation is good for growth and for the poor. That presumption is deeply flawed. While integration into global markets does offer opportunities for sustained and equitable growth, current approaches to import liberalisation are weakening the links between trade and poverty reduction.

In the previous chapter, we considered an aspect of international trade that has been characterised by insufficient liberalisation: the trade policies of industrialised countries. This chapter looks at the trade policies of developing countries. It argues that these policies have been characterised by an undue emphasis on rapid import liberalisation, with scant regard paid to the implications for poverty reduction and distribution. The point is not that trade liberalisation in developing countries is inherently bad for the poor. Integrated into effective national strategies for poverty reduction, well designed and properly sequenced trade reforms can create new opportunities for the poor. By the same token, trade-liberalisation programmes that create open markets without reference to the distribution of power in the market place can destroy opportunities. Many of the programmes associated with the International Monetary Fund and the World Bank fall into the latter category.

The first section of this chapter shows that developing countries, unlike industrialised countries, have been liberalising very rapidly. This has been encouraged through the system of incentives and penalties associated with IMF–World Bank loan conditions, which in turn reflect the policy priorities of Northern governments. One consequence is an unbalanced pattern of liberalisation. Developing countries are absorbing the costs associated with greater openness, while being denied access to rich-country markets.

The second part provides a critical review of the case for ‘openness’, as developed by the World Bank and adopted by Northern governments. That case is rooted in new adaptations of old trade theories. These theories predict a close relationship between
import liberalisation on the one side, and economic growth and poverty reduction on
the other. We show that the evidence in support of this case is weak. In summary, the
research behind the evidence has measured the wrong things, has deduced flawed
conclusions, and is generating bad policy advice. While the World Bank has moved
forward in developing a more coherent agenda for poverty reduction, it has failed to
integrate trade policy into that agenda.

Using a new analytical tool, the Trade Liberalisation Indicator (TLI), we highlight some
of the more serious shortcomings in the World Bank’s research, and most particularly
its confusion over what openness means. The TLI measures trade policies (such as tariff
levels and the speed and depth of liberalisation) over which governments have control,
rather than the indicators of economic outcomes (such as trade/GDP ratios) upon
which the World Bank concentrates. The TLI demonstrates the fact that the countries
that have integrated most successfully into the global economy, such as those in East
Asia, have proceeded cautiously with import liberalisation and placed more emphasis
on export promotion.

The third section of this chapter sets out some contrasting cases of trade liberalisation
in practice. It shows how badly designed trade-liberalisation policies can produce
outcomes that are bad for poverty reduction. Protectionism is no more a panacea for
poverty than rapid import liberalisation. The real challenge is to integrate trade reform
into effective national strategies for poverty reduction.

Trade liberalisation, growth, and poverty reduction:
the economists’ new religion

Economists are sometimes criticised for their failure to agree on policy prescriptions.
George Bernard Shaw once unkindly observed: ‘If all economists were laid end to end,
they wouldn’t reach a conclusion’ (Bucholz 1989). If he were writing today, he might
have been forced to concede a proviso: ‘unless they were talking about the benefits of
open markets for developing countries’.

Openness has become the new religion of much of the economics profession. Its
strongest adherents are to be found in the IMF, the World Bank, the WTO, and
Northern governments. Admittedly, the latter constituency applies the principles of the
faith on a selective basis: import liberalisation in the developing world is preferred to
liberalisation at home. Even so, their avowed faith in openness is impressive.

No G7 communiqué is complete today without reference to the potential benefits of
openness in developing countries in making globalisation work for the poor. The British
government, among the strongest advocates of openness, entertains no doubts.
According to the Department for International Development: ‘Empirical analysis shows
that greater trade openness contributes to higher growth (...) Recent cross-country
analysis shows that the poor benefit equally from the growth generated by trade
openness’. The IMF is equally convinced. One recent internal assessment of the Fund’s
approach to trade policy across a wide range of programmes concluded: ‘a clear message
from this review is that trade liberalisation has a positive overall effect on employment
and incomes of the poor’ (Bannister and Thugge 2001). The World Bank is
institutionally ambivalent on import liberalisation. In some places, it acknowledges the
complexity of the relationship between liberalisation and poverty reduction (for
example, World Bank 2001b). In others, it gives a simple but compelling signal to policy makers: ‘openness to international trade accelerates development’ (Dollar and Kraay 2001a). That signal has been reinforced by the economics profession. As one of the most respected authorities on trade policy writes: ‘there is widespread acceptance that in the long run open economies fare better in aggregate than do closed ones, and that relatively open policies contribute to long-run development’ (Winters 2000).

The main message to emerge is that the only good trade barrier is a low one or, better still, no barrier at all. Some caveats are attached. Governments are expected to provide ‘safety-nets’ for the unfortunate few who might be adversely affected by short-term adjustment costs associated with trade liberalisation, such as rising unemployment. They are also expected to combine trade liberalisation with a whole set of supportive reforms, in areas ranging from property rights to health and education. But none of this detracts from the imperative to liberalise.

**Trade liberalisation in developing countries**

There are various ways of measuring import liberalisation. Trade barriers include tariffs on imports, non-tariff barriers (such as quotas or prohibitions on some categories of imports), and taxes on exports. Whichever indicator is used, the pace of liberalisation in developing countries over the past 20 years has been extraordinary. Since the mid-1980s there has been widespread and rapid import liberalisation, undertaken not in the context of multilateral trade negotiations but under IMF–World Bank programmes (see below) or on a unilateral basis (UNCTAD 1998). Only a relatively small group of countries in East Asia has followed a selective and gradual approach to liberalisation, gearing integration in world markets towards well-defined national policy goals and institutional capacity. Elsewhere, there has been a widening divergence between developed and developing countries in the pace of liberalisation.

At the end of the 1990s, average tariffs were around one-half of their level at the start of the 1980s in South Asia and sub-Saharan Africa, and one-third of that level in Latin America and East Asia. Non-tariff barriers were widely prevalent at the start of the 1980s, covering more than one-quarter of all imports in East Asia and sub-Saharan...
Africa. With the partial exception of South Asia, these restrictions have been rolled back. Latin America, East Asia, and sub-Saharan Africa all halved the coverage of non-tariff barriers in the 1990s (see Figure 5.1).

Regional aggregates understate the scale and pace of liberalisation that has occurred in many countries. The following are not untypical examples:


- **South Asia.** Between 1988 and 1996, Bangladesh cut average tariffs from 102 per cent to 27 per cent. India halved average tariffs to 47 per cent in the three years to 1993.

- **Sub-Saharan Africa.** Between 1995 and 1998, Zambia cut its average tariff rate by a factor of four, to six per cent. Ghana, Kenya, and Tanzania cut tariff rates by one-half or more during the 1990s.

- **East Asia.** China, Indonesia, the Philippines, and Thailand all halved tariff rates in the 1990s.

Composite trade indicators underline the degree of liberalisation that has taken place. The IMF’s Trade Restrictiveness Index (TRI) combines the major types of trade barrier, including the average level of tariff protection, the coverage of non-tariff barriers, and export taxes. These are converted into a 10-point scale, with ‘1’ denoting the most open and ‘10’ the most restrictive. Countries are then assigned a ranking on this scale.

Two striking features emerge from the TRI ranking (see Figure 5.2). First, many developing countries have liberalised at an extraordinary pace. For example, Uganda, Peru, and Haiti have been among the world’s most rapidly liberalising economies. Between 1997 and 2000 alone, the proportion of low-income developing countries categorised by the IMF as ‘restrictive’ fell from 33 per cent to 18 per cent (IMF 2001). ‘There are exceptions to the general trend. Some very strong export performers such as Vietnam, China, and Indonesia have liberalised far more slowly, while others have
liberalised but remain relatively protected — an issue to which we return below.

The second strong conclusion to emerge from the TRI ranking is that many poor developing countries are now far more open to trade than rich industrialised countries. Liberalisation in developing countries has left the champions of free trade in industrialised countries trailing far behind.

- Countries such as Mozambique, Zambia, and Mali are far more open than countries in the European Union, such as the UK, France, and Germany. Sixteen sub-Saharan African countries covered by the TRI are more open than the EU.
- Peru and Bolivia are twice as open, and Haiti and Chile four times as open, as the United States and Canada. Seventeen countries in Latin America and the Caribbean are either as open, or more open, than the US economy.

**The role of IMF loan conditionality**

Trade-policy reform is an almost universal feature of IMF programmes, reflecting the commitment of its main shareholders — the major industrialised countries — to open markets in developing countries. When developing countries receive IMF loans, they also accept conditions requiring them to liberalise imports. These conditions, often implemented in tandem with World Bank programmes, carry considerable weight (IMF 1998). By virtue of its position at the apex of the conditionality system, the Fund is a gatekeeper to donor assistance, debt relief, and financial rescue packages. On its own evidence, IMF loan conditionality has produced some impressive results. An internal review in 1997 found that one-half of IMF programmes targeted quantifiable reductions in trade restrictiveness under their loan conditions. Whereas almost three-quarters of the countries covered in the 1997 review had restrictive trade regimes at the outset, four years later this number had fallen to one-fifth (IMF 1997, IMF 2001b).

No sector, including agriculture, is too sensitive to be prescribed the standard medicine of import liberalisation. Loans for Cambodia from the World Bank, and from the IMF’s Poverty Reduction and Growth Facility (PRGF), are conditional on the country reducing average import tariffs to 15 per cent by 2001, compared with more than 40 per cent in 1998. Mali has also been required to reduce tariffs on imports of rice, as has Haiti.

The number of trade-related conditions attached to IMF loans increased during the 1990s (IMF 2001b). This was especially true for low-income countries. For this group, the average number of such conditions increased three-fold between 1988-90 and between 1997-99, helping to explain their impressive performance on trade liberalisation. These averages mask the force of loan conditionality in specific countries.

The IMF’s concessional loan programme, the PRGF, is heavily weighted with trade-policy loan conditions. One review of seven PRGF programmes discovered a total of 51 trade-related policy measures. These ranged from conditions for entering a programme (13 measures), to benchmarks for measuring performance (11 measures). On average, every loan advanced to PRGF countries came with seven trade conditions attached, although several countries were above average in this respect. When Tanzania accepted a PRGF loan in 2000, it also agreed to eight specific policy measures aimed at liberalising trade, including the reduction of tariff and non-tariff barriers. Yemen accepted 22 trade-policy conditions on a loan from the same account.

While loan conditionality weighs more heavily on the IMF’s low-income clients, other countries are not immune. When Indonesia and Korea were forced to turn to the IMF
for support in the wake of the 1997 financial crash, their loans came with 19 and 9 conditions respectively, covering a wide array of policy reforms on both the import and export sides.

IMF programmes, supported by the World Bank in many cases, have often sought to promote import liberalisation at a pace that can only be described as heroic. Both Indonesia and Bolivia were expected to go from a TRI level of 4 (already as open as the EU or the USA) to 1 in the space of three years, implying massive structural change. Under IMF-World Bank structural adjustment programmes at the start of the 1990s, Peru and Zambia went from being among the world’s more closed economies to among its most open – in the space of a few years. In many ways, however, it is Haiti that stands out as the star pupil of the IMF–World Bank. The poorest country in the Western hemisphere, ranked 134 out of 162 on the UNDP’s Human Development Index, Haiti became in 1986 one of the few countries to reach the elevated status of a fully open economy, with a ranking of 1 on the Fund’s TRI (IMF 1999a). Guided by the IMF and the World Bank, Haiti had joined the super-league of trade liberalisers. The transition had appalling consequences for poor people, but the country is still praised by the World Bank in particular as a strong reformer (World Bank 2001b, Oxfam International 2001a).

Trade conditionality is applied irrespective of the reasons why governments seek IMF assistance. For example, Indonesia turned to the IMF following the 1997 financial crisis, which was rooted in the banking sector and exchange-rate policy. Yet financial ‘rescue’ came with trade-reform demands that were at best tangentially related to the underlying causes of the crisis. It is certainly not immediately apparent why IMF loan conditions required the liberalisation of imports for agricultural products and for a range of manufactured goods (Stiglitz 2001).

The scope and coverage of trade-policy conditionality implies a high level of confidence in the benefits of open markets. Before reviewing the quality of the evidence on which this confidence is based, it is worth noting some of the wider problems associated with current IMF–World Bank approaches to trade liberalisation, each of which has implications for poverty-reduction efforts.

• **Unbalanced liberalisation produces balance-of-payments pressures.** Import liberalisation has been accompanied by widening trade deficits across much of the developing world. The average deficit for developing countries as a whole in the 1990s was almost three percentage points of GDP higher than in the 1970s, even though average growth rates were lower (UNCTAD 1998). Two factors have contributed to this outcome. First, import liberalisation has led to surges of imports in many countries, with local industry being displaced. Second, trade restrictions in industrialised countries have limited export opportunities. Large trade deficits have been covered in a number of countries (notably in Latin America) by speculative flows of capital, creating instability and increasing exposure to economic risk. The Mexican financial crisis at the end of 1995, the East Asian crisis of 1997, and the Argentine crisis of 2001–02 were all, in part, a consequence of private capital flows being used to overcome balance-of-payments deficits.

• **Unequal trade negotiations.** When countries negotiate on trade reforms at the WTO, they exchange concessions. Governments agree to accept the costs implied by increased import competition, in part because they will obtain improved access
to the markets of trade partners: i.e. they receive something in return for liberalising. However, under IMF–World Bank programmes, countries liberalise on a unilateral basis, receiving nothing in return. It is true that, in their policy analysis and recommendations, the IMF and World Bank give the same advice to all countries. But loan conditions are applied only to developing countries. The result is unbalanced liberalisation, under which rich-country governments do not have to reciprocate measures undertaken by developing countries.

- **World Bank–IMF loan conditionality creates a ‘one system, two rules’ approach to trade policy.** When rich countries liberalise, their governments are highly sensitive to the views of domestic lobbies. Democratic accountability, and the power of vested interests, inform trade-policy choices. That is why the EU and the USA have taken several decades to undertake modest liberalisation in sensitive areas such as agriculture and footwear exports. In their policy advice to developing countries, the IMF and World Bank do not have to consider issues of accountability and democracy. They are accountable primarily to their main shareholders, which are Northern governments. As the IMF and the World Bank justifiably argue, they do not discriminate in the advice they offer. Northern governments are regularly urged to liberalise. However, unlike their Southern counterparts with loan programmes, they are not obliged to follow the advice they receive. It is unthinkable that the governments of France or the USA would liberalise their agricultural systems as rapidly as is required under some IMF programmes.

- **Severing the link between trade policy and poverty-reduction strategies.** In theory, the IMF and the World Bank are committed to putting poverty-reduction at the centre of their operations. In practice, as we show below, trade-liberalisation targets are set without reference to their implications for poor people.

### Growth, openness, and the poor: old arguments and new evidence

The application of IMF–World Bank loan conditions to trade liberalisation is one indicator of confidence in the benefits of openness. However, compulsion has not been the main force behind liberalisation; most developing-country governments have accepted the evidence that openness is good for economic growth, and by extension for poverty reduction. On closer inspection, that evidence is of dubious merit.

### The new model consensus

Economists have been asserting for a long time that trade liberalisation is good for developing countries. Some have done so on the basis of applied theory. This school points to the gains in efficiency that are presumed to flow from resource-allocation decisions in more open markets (Bhagwati and Srinivasan 1999, Bussolo and Lecomte 1999). Others have sought correlations between openness, growth, and poverty reduction through complex econometric data analysis.³

Econometric research has exercised a formidable influence over policy debates, even though (or, perhaps, because) the evidence produced is seldom comprehensible to policy makers. In the mid-1980s, one study claimed that countries that were more open to trade experienced on average an unconditional increase in economic growth of 2.5
per cent a year, compared with closed economies, and that they were heading for income convergence with rich countries (Sachs and Warner 1995). Other research reached similar conclusions and produced similarly inflated claims (Edwards 1993). Such studies informed a generation of structural adjustment programmes, fuelling general euphoria about the potential of trade liberalisation in the process. IMF–World Bank staff arrived in developing countries, armed with complex studies apparently justifying their prescription of sweeping trade-liberalisation measures.

Most of the studies – and even more so the policy conclusions based on them – lacked credibility. The majority failed even the most simple test of causality: it was impossible to determine whether openness caused growth, or whether countries became more open as economic growth increased. Moreover, definitions of ‘openness’ were so wide-ranging as to be meaningless. Everything from exchange rates and macro-economic strategies, to import barriers and the size of government were included. One detailed review found that when import barriers were isolated as an indicator of openness, any meaningful relationship with growth evaporated (Rodriguez and Rodrik 1999). In other words, there was no relationship, positive or otherwise, between the policies advocated by the IMF–World Bank and the policy outcomes predicted. Yet import liberalisation was dogmatically pursued as an adjustment goal.

Recent years have witnessed a resurgence in econometrics as a guide to policy formulation, with the World Bank in the lead. Some of the studies have continued in the worst traditions of the past, using broad definitions of openness that confuse trade policy with other aspects of macro-economic reforms (Edwards 1998). Others have shifted the focus to more narrowly defined indicators of openness, using these to identify associations with growth. Research carried out by the World Bank’s Development Research Group belongs in this latter category (Dollar and Kraay 2001a, 2001b). Almost all Northern governments, along with the IMF and the WTO, point to research carried out by the World Bank in pressing the case for import liberalisation in developing countries (for example, DFID 2000, McKay et al 2000). All of this prompts one to ask whether the new generation of research is any more robust than the last.

There are two core elements in the case presented by the World Bank. The first concerns the relationship between economic growth and poverty reduction. On the basis of an econometric exercise analysing economic growth in 80 countries extending over four decades, the World Bank argues that on average the income of the poor rises on a one-to-one basis with overall growth. In other words, poor people capture a share of any increment to growth that reflects their existing share of income distribution. As the authors express it, in a sentence that has been reproduced many times by Northern government development agencies: ‘It is almost always the case that the income of the poor rises during periods of significant growth’ (Dollar and Kraay 2001a).

The second element seeks to establish a link between growth and openness. It avoids some of the pitfalls of the earlier studies by using a single indicator of openness: the ratio of trade to GDP. In an econometric study covering a sample of 72 developing countries, the World Bank examines the relationship between economic growth and the trade/GDP ratio. More specifically, it singles out the top one-third of developing countries in terms of increases in trade to GDP ratios over the 20-year period 1975-79 and 1995-97, distinguishing this group of ‘globalisers’ from the rest (‘non-globalisers’). Some strong conclusions emerge. Among the most important, and widely cited by policy makers, are:
• Weighted for population (an important statistical device, as we show below), the per capita income of the ‘globalisers’ grew at five per cent a year in the 1990s, compared with 1.4 per cent for the ‘non-globaliser’ group.

• Growth rates for the ‘globalisers’ have been steadily increasing since the mid-1970s, while those for the non-globalisers fell sharply in the 1980s and recovered only marginally in the 1990s.

• Per capita income among the ‘globalisers’ is rising more than twice as fast as in industrialised countries, while the ‘non-globalisers’ are falling further behind.

At one level, it is unsurprising that such findings have attracted the attention of policymakers. The implied divergence in economic growth rates is very large. Countries that are open, on the definition used in the study, are growing at 3.6 per cent a year faster than others. On this basis, average income in a globalising economy would double every 14 years, compared with 50 years in a non-globalising economy: a growth gap that would have profound implications for poverty reduction.

On closer inspection, however, some of the numbers look less impressive. One reason for this is that averages have the effect of obscuring important differences between countries, especially when samples are weighted for population (since this means that large countries like China have a disproportionate influence). Using an unweighted average, the per capita growth rate for the globalisers in the 1990s falls to 1.5 per cent. Moreover, 10 of the 24 countries in the group have growth rates of one per cent or less. Further disaggregation reveals that one-third of the ‘globalising’ countries have lower average growth rates for the 1990s than the ‘non-globalising’ group. This would hardly appear to be a strong basis for advocating the policies associated with ‘openness’, even if those policies could be readily identified.

Such findings do not necessarily imply that there is no positive relationship between openness and growth. Several studies have supported the finding that openness, as measured by the share of trade in income, is related to long-term growth (Frankel and Romer 1999). The problem with these studies is one of interpretation. It is almost axiomatic that countries with growing trade/GDP ratios will have higher than average growth rates, since world trade is growing more rapidly than global GDP. However, association is not the same as causation: it could be that countries participate more in trade because they are growing more rapidly. The only conclusion that can be supported with any confidence is that countries tend to become more open as they become richer (Rodrik 2001a).

The selection of reference periods and thresholds for ratios can dramatically change the findings from any large cross-country sample. Dani Rodrik of Harvard University has used the same data as the World Bank study to rank the top 40 countries in terms of the increase in imports in their GDP and tariff reductions over the periods 1980-84 and 1995-97 (Rodrik 2001d). The results show a steady decline in growth rates from four per cent in 1975 to 2.5 per cent in 1985 and less than two per cent in 1995.

It would doubtless be possible to arrive at different results by changing these reference years and indicators. Any number of outcomes might emerge. In itself, this would suggest a case for extreme caution in interpreting results. But the strong suspicion emerges that reference years and countries have been carefully selected, and the interpretation of data presented, to produce a systematic bias in favour of a positive association between openness and growth.
What is wrong with openness?

Leaving aside statistical interpretation, the use of openness as an indicator by the World Bank produces some superficially compelling comparisons. Strongly performing ‘globalisers’, such as China, Vietnam, and Thailand, with a track record of rapid growth and poverty reduction, are contrasted by the World Bank with under-performing ‘non-globalisers’, such as Burma, Pakistan, and Honduras (Dollar and Kraay 2001b). Implied causal association is there for all to see: openness spells success, and lack of openness leads to economic failure and poverty. As one commentator puts it: ‘Openness to trade has many dimensions, and all of these dimensions are positively associated with growth’ (Easterly 2001).

The problem with such statements is that they are virtually meaningless in terms of their policy application. Openness as a concept in trade policy has at least two very different meanings. The World Bank uses it to describe what is essentially an economic outcome, captured, in this case, in the ratio of trade (defined as imports plus exports) to GDP. The Bank then undertakes a leap of imagination to a second meaning: namely, implied policy inputs. That leap is acknowledged, albeit cursorily, when the authors declare that ‘we use decade-over-decade changes in the volume of trade as an imperfect proxy for changes in trade policy’ (Dollar and Kraay 2001b). To put it mildly, it is a very imperfect proxy.

If the aim is to examine the relationship between trade policy, growth, and poverty reduction, then it is indicators of trade policy (not economic outcomes) that have to be tested. When they are tested, the World Bank view appears as an upside-down version of reality. It turns out that some of the most successful globalisers are anything but radical liberalisers, while many of the most radical liberalisers have actually achieved very little in terms of economic growth and poverty reduction.

The distinction between economic outcomes and policy inputs is an important one, especially from a policy perspective. Governments have limited control over trade/GDP ratios. They reflect a wide range of factors, including export prices and the structure of the economy (poor countries with large mineral deposits often have larger export/GDP ratios, for example). On the other hand, policies are subject to government influence. Levels of tariff and non-tariff barriers, for example, and the speed at which they are reduced, are matters of political choice.

Oxfam has developed a new analytical tool, the Trade Liberalisation Indicator (TLI), which casts the debate on trade liberalisation in a new light. The TLI focuses on two important trade-policy variables: namely, the speed and depth of liberalisation.

- **Speed of reform.** The TLI attempts to capture this dimension by taking the three-year period in the 1990s during which average tariffs were subject to their most rapid reduction. Countries that cut tariffs by more than 30 per cent during this period are categorised as ‘rapid liberalisers’, and those that cut them by less than 30 per cent as ‘slow liberalisers’. As with any indicator, this one is not unproblematic. The cut-off point is arbitrary, and tariffs are only one part of the protective apparatus deployed by governments. However, it is widely accepted that average tariff levels provide a reasonable reflection of the overall restrictiveness or openness of trade regimes (Dollar and Kraay 2001b).

- **Depth of liberalisation.** Depth matters as much as speed, not least since countries liberalise from very different starting points. A country that halves tariffs from a
Figure 5.3
The Trade Liberalisation Indicator (TLI): the speed and depth of import liberalisation in selected developing countries.

*Data from the 1980s

1 The percentage reduction in tariffs is calculated using average weighted tariffs. The formula used is as follows: ([Initial value – Final value] / Initial value) x 100. In other words, if a country cuts tariffs from 80 per cent to 40 per cent, the reduction would be 50 per cent.

2 The final level of protection has been obtained by using the IMF’s Trade Restrictiveness Index (TRI) matrix, applied in this case only to import measures (the TRI also measures export taxes).

Figure 5.4
Economic growth and poverty reduction: selected groups of developing countries.

1 Growth rates have been calculated from the data in the World Bank’s World Development Indicators 2000.

2 The average yearly change in poverty has been calculated as follows: ([Final headcount – Initial headcount] / number of years).

Note: The data used in Figures 5.3 and 5.4 is available on www.maketradefair.com
very high level is clearly not in the same position as a country that halves already low tariffs. The TLI captures this dimension by adapting the IMF’s Trade Restrictiveness Index. This ranks countries on a scale of 1–10, using the standard IMF matrix system for tariff and non-tariff barriers. However, since the focus is on understanding import policies, it does not include export taxes. Countries with a TRI of less than 5 are categorised as ‘relatively open’, and those ranked at more than 5 as ‘relatively closed’.

Figure 5.3 shows the results of applying these indicators to a sample of 33 developing countries in the 1990s, with seven additional cases from the 1980s. What emerges is a kaleidoscopic effect. Instead of the two distinct camps of ‘globalisers’ and ‘non-globalisers’, there is a broad scatter of countries.

Measured by the TLI indicators of speed and depth of liberalisation, many of the developing countries that are synonymous with successful integration into global markets register as modest liberalisers. China, Indonesia, and Vietnam may be first-division ‘globalisers’ on the World Bank’s criteria, but they are decidedly second-division liberalisers. The same would apply to Mauritius. Similarly, East Asian countries in the 1980s were able to combine high growth with high degrees of protection.

At the other end of the spectrum, many of the countries that conform most closely to the prescription in favour of rapid liberalisation are hardly models of successful integration, let alone models of good trade policies. This group, located in the bottom-right quadrangle of the scatter graph, includes Haiti, Zambia, Nepal, Mali, Peru, and Bolivia. While these countries may be world-beaters in setting import-liberalisation standards, their achievements in other areas (economic growth, poverty reduction, and human development) leave much to be desired.

This is illustrated in Figure 5.4, which provides data on economic growth and poverty reduction, measured by average annual change in the incidence of poverty. It should be emphasised that this is a relatively small sample of countries, and that there are serious problems with data on poverty levels. Even so, some of the findings call into question the current tendency to celebrate and encourage openness in trade policy. Many rapid liberalisers have a weak record on both economic growth and poverty reduction. Meanwhile, many of the countries that have proceeded more cautiously on import liberalisation have sustained far higher economic growth rates and achieved a strong record on poverty reduction. Between these two extremes, a wide range of outcomes is possible.

The purpose of the TLI is not to replace the World Bank’s current blueprint with another, or to imply that restrictive trade policies are inherently better for poverty reduction. Indeed, the only strong conclusion to emerge is that a diverse array of outcomes is possible. But it is this very diversity that cautions against the application of a universal set of policies in favour of rapid trade liberalisation. Far more attention needs to be paid to understanding why and how trade reforms are associated with very different outcomes in terms of poverty reduction.
Why distribution matters

As noted earlier, the argument that openness is good for growth has been closely associated with the argument that growth is good for the poor. Taken at face value, this is an uncontroversial proposition. It is certainly the case that the poor are more likely to benefit from economic growth than they are from economic decline. However, the narrow focus on growth has tended to obscure the importance of distributional factors in determining the rate at which growth is converted into poverty reduction.

The apparently simple proposition that growth is good for the poor is in fact based on another large-scale World Bank cross-country data analysis. That analysis arrived at the following conclusion: ‘Income of the poor rises one-for-one with overall growth .../.../...Openness to international trade raises the incomes of the poor by raising overall incomes. The effect on distribution of income is tiny and not significantly different from zero’ (Dollar and Kraay 2001a). This statement summarises much of the received wisdom on the relationship between trade reform and poverty reduction. The logic is disarmingly simple. On average, so the argument runs, the income of poor people rises in proportion to their existing share of national income. It follows that when national income rises, the income of the poor will rise with it. Other things being equal, since openness to trade raises average income, trade is good for growth and for the poor in equal measures.

The problem is that, in the case of income distribution, other things are not equal. For policy makers interested in poverty reduction, what matters is the interaction of two factors: the rate of growth, and the proportion of any increment to growth captured by the poor. In crude terms, the rate of growth decides the size of the economic cake, while distribution decides how it is sliced up.

To say that on average the incomes of the poor will rise on a one-to-one basis with overall growth is of dubious relevance to poverty reduction. If the poor account for only a small share of national income, they will capture only a small share of any increase in income. For example, with no change in income distribution, the income gain for the richest 20 per cent will be five times higher than for the poorest 20 per cent in India, 14 times higher in Mexico, and 24 times higher in Brazil. Hence, even though the income of the poor may rise on a one-to-one basis with overall growth, it will rise by less in countries with high levels of inequality (Hanmer and Naschold 1999, Stewart 2000). The fact that the income gain for the poorest quintile will be less than the income gain for the rich and for the nation as a whole implies a slower rate of poverty reduction than would be achieved if growth were combined with redistribution.

This point has profound relevance for poverty reduction. Based on existing income-distribution patterns, Brazil has to grow at three times the rate of Vietnam to achieve the same average income increase in the poorest one-fifth of the population. Similarly, Mexico would have to grow at almost twice the rate of Indonesia or Uganda to achieve a similar increase (Watkins 1998). The same rate of growth can thus produce very different effects in terms of poverty reduction across countries. As one survey of cross-country evidence has shown, countries with low inequality can expect to see from the same growth rate a 75 per cent higher rate of poverty reduction than countries with high inequality (Ravallion 2001). Even though the effects of economic growth may be the single most important determinant of poverty-reduction trends worldwide, distribution remains critical. One cross-country study, covering 143 growth episodes, has shown distribution to play a stronger role than growth in increasing the income of the poor in
more than a quarter of the cases (White and Anderson 2001).

By the same token, changes in patterns of income distribution can influence poverty-reduction efforts, for better or for worse. By international standards, Bangladesh has a relatively even distribution of income. However, rapid export growth in the first half of the 1990s was accompanied by rising inequalities. The Gini coefficient rose from 26 to 31 between 1992 and 1996. Without these inequalities, it is estimated that there would be 8–11 million fewer people living on less than $1 a day (based on Appleton et al. 1999b, Woodon 1999). If relatively unequal Honduras had the same Gini coefficient as more equal Costa Rica, this would result in a seven per cent decline in the incidence of poverty (Government of Honduras 2001).

Initial inequalities interact with the pattern of economic growth to determine the rate at which rising average incomes translate into poverty reduction. Where growth is concentrated in areas where the poor are heavily represented, such as labour-intensive manufacturing and agriculture, it is likely to reduce poverty more rapidly than in other areas (such as capital-intensive farming and industry). During the first half of the 1990s, countries such as Uganda and Vietnam achieved broad-based growth based on smallholder agriculture. The ratio of the increase in per capita income to the decline in the incidence of poverty was close to 1:1 for both countries. However, for countries such as India and Peru, the ratio was around 1: 0.25, and in these cases the rural poor in particular appear to have been excluded from the benefits of growth.

There is a two-way interaction between distribution and economic growth. Research suggests that high levels of inequality not only slow the rate of poverty reduction, but also restrict the rate of economic growth. Various reasons have been identified. Where extreme inequality is a major cause of poverty, it restricts investment, undermines the development of markets, and hampers innovation (UNDP 2001a, Dagdeviren et al. 2000). This suggests that redistribution may offer a double benefit for poverty reduction, by increasing both poor people’s share of the economic cake, and the size of the cake itself.

Given the vital importance of distribution, one of the first questions in the design of any trade-reform policy should be how it will affect the poor: more specifically, what policies are likely to increase not just the overall level of growth, but also the share of any increment to growth captured by populations living below the poverty line. In this context, the common presumption that liberalisation is good for growth in general is not a good starting point.

**Trade liberalisation and poverty reduction**

The case for rapid trade liberalisation in developing countries echoes the broader case for free trade set out in Chapter 1. It is based on the proposition that trade liberalisation is good for growth in general and for the poor in particular. The problem with this perspective is that it ignores some of the complex issues raised by trade policies. These relate to distributional outcomes, the sequencing of reforms, and the timeframe applied for measuring benefits.

**The distribution of benefits from liberalisation**

At its simplest, standard trade theory suggests that free trade will allow countries to
specialise in what they do best, exporting the products in which they have a comparative advantage, and importing those that reflect comparative advantage elsewhere. Because interference with trade (whether through export taxes or import barriers) distorts prices by taxing efficient producers and subsidising inefficient ones, the presumption is that it is bad for growth, and hence bad for poverty reduction.

Trade theory assumes a pro-poor distributional bias when applied to developing countries. Because comparative advantage is presumed to lie with labour-intensive goods, increased demand for such goods through exports is expected to push up the

Box 5.1

Import liberalisation, poverty, and inequality in Mexico

Mexico bears all the signs of success in applying the principles of openness. Yet the country has combined rapid liberalisation with rising inequality and a poor record on poverty reduction. The design of the liberalisation programme has contributed to the problem.

Under trade reforms initiated in the mid-1980s, the country halved average tariffs to 12 per cent. Import licensing, which covered more than 90 per cent of products in the mid-1980s, covered less than one-fifth of exports by 1990. Since accession to NAFTA in 1996, Mexico has been integrating with the USA, the world's largest economy, opening up sectors such as agriculture and manufacturing to increased competition. Meanwhile, rapid export growth has increased the export/GDP ratio from less than one-fifth to almost one-third since 1990.

Rapid trade liberalisation has been associated with a weak record on poverty reduction. Despite per capita GDP growth rates of two per cent in the first half of the 1990s, the number of poor people increased. By the mid-1990s, there were 14 million more people living below the poverty line than in the mid-1980s. Rising inequality accounted for about 80 per cent of the increase, with the Gini co-efficient rising from 49 to 55. Why has rapid integration produced such modest outcomes for poverty reduction?

Distributional factors provide part of the answer. More than 80 per cent of extremely poor people in Mexico live in rural areas, with a heavy concentration in the poverty-belt States of the south. Many are involved in the production of corn. This crop accounts for about half of the total farm acreage in the country, and two-thirds in the poorest rain-fed areas. Import liberalisation has allowed heavily subsidised, cheap US corn to flood into Mexico, driving down local prices. At the time of entry to NAFTA, Mexican domestic prices were almost double subsidised US prices, threatening the livelihoods of an estimated 2.4 million farmers.

Although agricultural exports have been growing rapidly, the impact on the incomes of the very poor has been muted. In agriculture, the winners have been the large commercial farms located in areas such as the North Pacific Coast and the irrigated valley of El Bajio. Production of fruit and vegetables for export to the USA has created employment, primarily of a low-wage, temporary variety. But production is capital-intensive, and it is unlikely that new employment opportunities have outweighed the costs to the poor of import liberalisation.

In the urban sector, trade liberalisation appears to have biased income distribution away from low-waged, unskilled labour. Although foreign investment has created a large number of jobs in the maquiladora zone, wages are exceptionally low (see Chapter 3). Despite this, there is evidence that foreign investment is creating demand for more skilled labour.

price of labour producing them. Since poor people are most dependent on labour, trade-liberalisation models predict that they will gain in relative and absolute terms. Exports of labour-intensive manufacturing and agricultural goods are assumed to generate automatic gains for poverty reduction.

For all the certainty with which it is promoted, detailed research into the relationship between openness and the incomes of the poor provides scant encouragement for standard trade theory. One piece of cross-country research, produced by the same World Bank division that claims such strong benefits for trade liberalisation, confirmed a positive aggregate relationship between aggregate income and economic openness. However, it found that the aggregate outcome concealed important distributional changes. Openness was correlated positively with income growth among the richest 60 per cent, but negatively among the poorest 40 per cent. It concluded: ‘While greater openness benefits the majority, it harms the poorest ... the costs of adjusting to greater openness are borne exclusively by the poor’ (Lundberg and Squire 1999).

Like all theories, conventional trade theories are predicated on restrictive assumptions. Once those assumptions are violated, their value as a guide to policy formulation is eroded. What actually happens to poverty when countries liberalise depends on many factors. Initial distribution of income and assets, what the poor produce, gender relations within the household, and – not least – the specific types of reform undertaken all matter a great deal (Winters 2000). Where trade restrictions have benefited poor people by raising the price of the goods they produced, it can be predicted that liberalisation will hurt the poor. Under almost any conceivable set of conditions, trade liberalisation will produce winners and losers. But poor people often figure prominently among the losers. And since they frequently lack the assets, skills, and access to markets required to take advantage of new opportunities, it may be difficult for them to join the ranks of the winners. The degree to which women benefit will be determined by what they produce, and by the division of labour between men and women. There is no guarantee that any increase in growth will enable the poor to catch up, or women to share in the benefits of growth.

**Labour-intensive manufacturing, employment, and wages**

The rapid growth of labour-intensive manufactured exports in a number of developing countries is sometimes cited as evidence in defence of standard trade theories. These exports have unquestionably generated important benefits in terms of employment creation, especially for women. Yet the benefits have been more restricted than expected, and accompanied by considerable costs. Why have real-world outcomes confounded trade theory?

In part, the reason is that many labour-intensive sectors in developing countries were heavily protected. Far from creating employment and increasing wages among low-paid, unskilled workers, trade liberalisation has frequently undermined employment among the poor and widened wage gaps. The reason: adjustment costs have been concentrated in labour-intensive sectors, while employment creation and export opportunities have been concentrated in sectors requiring higher levels of skills and wages. This effect has been observed for a large group of countries in Latin America, including Mexico, Brazil, Chile, and Colombia (Contreras et al. 2000, Velez et al. 1999, Revenga 1997). Rapid import liberalisation in Mexico in the mid-1980s was associated with a decline of one-third in the real value of the minimum wage. Around one-quarter of this decline was directly attributable to a reduction in tariffs and other import restrictions (Harrison and Hanson 1999). While wages among skilled workers also initially declined, they rose...
sharply after 1998. By the mid-1990s, they were 20 per cent above their pre-liberalisation levels, while the wages of the unskilled were 10 per cent below those levels (Lustig and Szekely 1998). Rising wage inequality was one of the factors behind the slow rate of poverty reduction achieved in Mexico during the first phase of liberalisation (see Box 5.1).

The effects on employment creation associated with trade liberalisation have often been very small, with a bias towards higher levels of skill (Moreira and Najberg 2000, Marquez and Pages-Serra 1998). Although foreign investment has increased demand for labour in many countries, it reinforces that bias. This appears to be true even in Mexico’s maquiladora zone, despite the low-skill nature of much of the assembly work undertaken there (Harrison and Revenga 1998, Cragg and Epelbaum 1996). Conversely, employment destruction is frequently concentrated in areas where the poor are disproportionately represented. This mismatch in outcomes has been an important factor behind rising inequalities.

The case of India, following its rapid trade-liberalisation programme introduced in 1991, demonstrates the point. Between 1990 and 1994, the average tariff was reduced from 125 per cent to 50 per cent (Joshi and Little 2001). The textile industry was one of the sectors most immediately affected. Between 1994 and 1996, 52 mills closed in Ahmedabad alone, with a loss of over 100,000 jobs, accelerating a process of restructuring in the textile industry that was already underway. With few alternatives in the organised sector, most retrenched workers turned to the informal sector, where their conditions in terms of wages, working hours, and welfare provision deteriorated. Retrenched workers in the informal sector reported average wages of around one-third of the level in textile factories (Howell and Kambhampati 1999).

Set against this experience, trade liberalisation has certainly created new opportunities in India. The liberalisation of investment and export incentives has fuelled a boom in high-technology products. Between 1990 and 1999, exports of information and communication technology rose from $150m to $4bn, creating some 180,000 jobs in the process (Landler 2001). In terms of net employment and economic welfare, export growth in this sector may have outweighed the losses associated with import liberalisation in textiles. However, the winners have been mainly educated workers from middle-income households, while the losers have been less skilled workers from poorer households.

There are important differences between, as well as within, countries in terms of the outcomes associated with trade liberalisation. While effects on employment have been muted in much of Latin America, labour-intensive growth has generated high levels of employment creation in parts of South Asia and East Asia. The garment and textile industries in Bangladesh, Indonesia, and Cambodia, and the micro-electronic assembly industries of the Philippines and Thailand are cases in point. Even so, there is a broad sense in which trade liberalisation under globalisation is producing unexpected outcomes. Among the main factors:

- **Changing skill composition.** Technological change and foreign investment are generating patterns of export from developing countries with a bias towards more skilled workers. The premium on literacy and education is rising, while demand (and wages) for workers lacking basic literacy skills are falling (Cornia 2000).

- **Intensified South–South competition.** East Asia is often promoted as a model of labour-intensive, export-led growth over the two decades from the mid-1960s.
Since then, globalisation has changed the world in fundamental ways. Export-orientation and increased foreign investment have intensified competition, with a large population in low-income countries entering global markets (Wood 1997). When Latin America started to liberalise in the 1980s, its workforce came into competition not just with workers in industrialised countries (where wages were higher), but with workers in developing countries (where wages were, in many cases, much lower). The average income of a Bangladeshi garment producer is $1.50 a day, compared with a Mexican minimum wage of $4 a day. The entry of China in particular into global markets has had the effect of dampening demand for labour in competitor countries.

- **Rapid transition to open markets.** One factor behind the high rate of job losses in many developing countries is the presence of enterprises that have grown up behind trade barriers. Unable to cope with a rapid surge of foreign competition on domestic markets, and lacking access to the technologies needed to compete on world markets, large numbers of firms have closed. Sub-Saharan Africa appears to have suffered heavily from this effect (Wangwe 1995).

- **Weakening of labour rights and gender discrimination.** As shown in Chapter 3, the relationship between employment creation and real wage increases has been weakened by two important factors. First, wage discrimination in the context of labour-market feminisation is reducing average wages. Second, the erosion of collective bargaining rights is limiting the ability of employees to claim a bigger share of the value of production.

**Costs and benefits of liberalisation in agriculture**

In agriculture, as in industry, trade liberalisation changes the returns on various assets. On the import side, it will increase competition for domestic farmers as the price of competitive products falls. For exporters, the removal of export taxes and other incentives can create new market opportunities. Capacity to adjust to increased competition and take advantage of new opportunities is determined by a wide range of factors, including access to land, marketing infrastructure, and what poor people are producing. Given that women account for around two-thirds of food production and a disproportionately large share of the rural poor, gender-determined roles in production and marketing play a crucial role.

Trade restrictions have often penalised smallholder farmers. At the end of the 1980s, export taxes and exchange-rate over-valuation meant that coffee farmers in Uganda gained only ten per cent of the world-market price of exports (Oyejide, Ndulu, and Gunning 1999). When that tax was lifted with liberalisation, exports and smallholder farm incomes rose rapidly. In Vietnam, domestic marketing restrictions meant that small rice farmers were unable to produce for global markets. The removal of those restrictions expanded market opportunities (World Bank 2000a). In both countries, the dominance of smallholder farmers over production meant that export growth had powerful effects in terms of reducing poverty (see Chapter 2).

Import liberalisation can have very different distributional outcomes. Where production is dominated by large-scale agriculture (as with sugar in the Philippines, for example), relatively rich farmers will gain and poor consumers lose as a result of protectionism. On the other hand, adverse effects would be predicted if the withdrawal of import protection exposed poor farmers to intensive price competition. In many cases, poor smallholder farmers absorb a disproportionately large share of the costs associated with
Box 5.2

Peru: the costs of rapid liberalisation

In the early 1990s the IMF–World Bank supported one of the world’s most radical trade-liberalisation programmes. It was implemented under the government of Alberto Fujimori through a ‘shock therapy’ programme. Peru emerged, according to the IMF’s classification, as one of the world’s most open economies. The design of the reforms, which was heavily influenced by powerful agri-business interests, contributed to widening inequalities in the rural sector, compounding poverty in the process.

Import liberalisation and export promotion were twin cornerstones of the Fujimori agricultural strategy. Before 1990 the average import tariff was 56 per cent. In 1991 an upper tariff rate of 15 per cent was introduced for most agricultural products, with further cuts in 1996. Marketing boards, previously used to defend minimum prices for agricultural products, such as rice, were effectively removed. Meanwhile, tax incentives and public finance were directed towards the promotion of export agriculture.

The reform programme followed intensive lobbying from a consortium of food importers and processors. Led by the Alicorp corporation, an important source of finance for the presidential election campaign, the food industry argued that lower import tariffs and the withdrawal of price support would reduce prices of basic foods, helping to reduce inflation. Alicorp itself represents the major food importers and processors, such as the Nicolini and Romero groups, for whom lower trade barriers meant access to cheaper products on world markets.

As expected, food imports increased dramatically in the wake of liberalisation. In volume terms, average food imports increased from 1.6m tonnes in the first half of the 1990s to 2.7m tonnes in the second half. Exports increased less rapidly than imports, leaving the country with an annual agricultural trade deficit of $346m for 1996-9.

Food imports now account for around 40 per cent of total national food consumption in Peru. Import growth has been especially rapid in some of the key cereals markets. Wheat imports doubled during the 1990s to 2.5 million tonnes. In 2000, imports of hard maize overtook domestic production, exceeding one million tonnes. Milk imports rose by a factor of three in the first half of the 1990s alone, before falling back slightly in the second half of the decade. Increasing imports have played an important role in forcing down the prices received by Peruvian farmers.

How has increased import competition affected rural poverty? There are variations across sectors:

Dairy farming. Twenty years ago, dairy farming was dominated by small producers in central highland areas such as Arequipa and Cajamarca. During the 1990s, as competition with imports intensified, there was an accelerating trend towards larger-scale farming around Lima and nearby coastal valleys. Traditional farmers were unable to compete with price competition from imported milk supplied by New Zealand, Australia, and, on heavily subsidised terms, the European Union.

Rice. Most of Peru’s rice is produced by small-scale farmers in the southern and northern coastal valleys, and in the jungle department of San Martin. These farmers have had to absorb sharp price falls in the face of imports from Thailand and other low-cost producers.

Maize. Commercial farms in the coastal valleys around Lima and Libertad have been able to cope with increased competition. Average yields are relatively high, and transport costs to urban markets are low. By contrast, farmers in jungle areas such as San Martin have productivity levels less than half of those in coastal valleys, and face higher marketing costs. Price pressures are producing growing disparities between these two groups of producers.

Food staples. Cheap wheat and rice imports are increasing the price competition facing smallholder farmers who produce traditional Andean products such as quinua, beans, and
liberalisation, while richer farmers capture a disproportionately large share of the benefits accompanying export growth. Because of the dominant role of women in the production of food crops, they are often adversely affected by import liberalisation.

This problem is illustrated by Haiti’s programme of rapid trade liberalisation, implemented under IMF–World Bank auspices from the mid-1980s onwards. In 1995, import tariffs on rice were cut from 50 per cent to 3 per cent, opening the door to heavily subsidised imports from the United States. In real terms, prices for rice fell by 25 per cent in the second half of the 1990s. Unable to compete with cheap imports, domestic producers were pushed out of local markets. From a position of near self-sufficiency in 1990, by the end of the decade national production of paddy had fallen by almost half, to 105,000 tons (IMF 1999a and 2000). Subsidised exports from the USA accounted for more than half of the domestic market.

Urban populations in Haiti have benefited from cheaper rice, while smallholder rice producers have seen their livelihoods devastated. In a country where more than half of all children are malnourished, and more than 80 per cent of the rural population live below the poverty line, rice-growing areas have some of the highest concentrations of malnutrition and poverty (Oxfam International 2001a). Farmers in the Artibonite Valley, one of the main rice-growing areas, interviewed by Oxfam in mid-2001, were still suffering the consequences of increased competition. One of them commented: ‘While rice is so cheap, we can never find a way out of our poverty. These imports make our lives impossible. I can no longer afford fertilisers, so I am producing less. My farm no longer grows enough even to feed this family. There is not enough money for health care and education.’

In each of these sectors, trade liberalisation has reinforced old structural inequalities based on access to assets and markets. Smallholder peasant agriculture has fallen further behind, especially in the sierra. For the 1.5 million households in the sierra surviving on smallholdings of less than five hectares, liberalisation has been associated with accelerated marginalisation.

Developments in agriculture have been part of a broader trend. Weak and variable as it has been, economic recovery in Peru during the 1990s was accompanied by rising inequality and a deteriorating record on poverty reduction. Between the start of the reforms in 1991 and 1997, the Gini co-efficient in Peru rose by 4 points (to 50.6) – one of the most rapid increases in inequality recorded in Latin America. Over the same period, the income share of the richest one-tenth increased from 35 per cent to 39 per cent, while that of the poorest tenth fell from 15 per cent to 12 per cent.

According to the Economic Commission for Latin America, the proportion of the rural population living in poverty increased by 20 per cent in the decade to 1995, to almost two-thirds of the total.

Import liberalisation is not the primary cause of these adverse trends. Chronic under-funding of rural infrastructure, limited access to credit, and failure to develop a coherent rural development strategy have all contributed. At the same time, rapid and badly designed import liberalisation has reinforced wider pressures on poor farmers. Larger commercial farms have also faced adjustment costs, but have vastly superior access to infrastructure, credit, and markets, with the result that inequalities within the rural sector are widening.

Source: Crabtree 2001
Rice farmers have responded to the impact of lower prices on their livelihoods by cutting costs in other areas (such as health and education), and increasing off-farm employment, with women taking on more work as rural labourers. Notwithstanding the income gains for rice consumers, the country has been left dangerously dependent on food imports, which it cannot secure on a sustainable basis, for lack of foreign exchange. Moreover, increased rural poverty has been spread from the farmers most directly affected to extend across the rural economy, with adverse effects for agricultural wages and small-scale enterprises.

Import liberalisation is often designed in a manner that shields politically powerful lobbies, while subjecting marginal groups to more intense competition. In India, high tariffs have been maintained for rice farmers, but in 1996 import taxes on edible oils were dramatically cut, ostensibly to provide oil processors and consumers with access to cheaper products. Over the next two years, imports of vegetable oils increased five-fold, to five million tonnes. Malaysian palm, Indonesian coconut, and Brazilian and Argentinian soya flooded local markets, driving down domestic prices by 20 – 40 per cent (Sharma 2000). The consequences for rural poverty have been severe. Oilseeds are the second largest group of agricultural products in India, with about 14 million households directly engaged in production. Since the crop is extensively produced in dryland areas, where rural poverty is concentrated, the price falls would have directly affected the poor. Severe hardship was reported among oilseed producers in Andhra Pradesh and among coconut farmers in Kerala (Sharma 2000).

At the same time, trade liberalisation in India has unquestionably created new opportunities for commercial farmers. In Maharashtra and Gujarat, State governments are supporting the development of large-scale agro-export schemes for the production of grapes, vegetables, and other crops. In Andhra Pradesh, the State government is promoting through its Vision 2020 plan the introduction of genetically modified cotton and irrigated fruit production (IIED 2001). However, participation in export markets such as these requires access to irrigated land, capital, and technologies that are beyond the means of the poor. It is difficult to see how such a model of growth is likely to improve significantly India’s disastrous record on rural poverty, which accounts for over two-thirds of the national total. At the end of 1997, the incidence of poverty in rural areas was 34 per cent, the same level as in 1989 (Jha 2000). Over the same period, the rural Gini co-efficient increased by three points. Imposing a pro-rich pattern of trade liberalisation on these foundations is hardly a good basis for human development.

In countries with high concentrations of rural poverty, the combination of rapid import liberalisation in food staples and the promotion of capital-intensive export production can have profoundly anti-poor outcomes. Mexican agriculture has seen growing divergences in wealth between commercial farms linked to the US economy in the north, and smallholder agriculture in the ‘poverty-belt’ States of the south. By enabling subsidised corn to enter local markets at prices cheaper than many domestic farmers are able to compete with, import liberalisation has threatened the mainstay of the rural economy of the poor (see Box 5.1). In Peru, rapid liberalisation across a wide range of agricultural commodities in the early 1990s, again under IMF–World Bank auspices, has intensified inequalities between small and large producers, between farmers located close to and more distant from major markets, and between regions. Indigenous communities in highland areas, where the concentration of poverty is among the highest in the country, have seen markets for basic food staples captured by importers (Box 5.2).
Patterns of liberalisation such as these help to explain one of the anomalies revealed by the TLI: namely, the poor performance of rapid liberalisers in terms of poverty reduction. Rising inequalities reflect the development of market structures that are tending to reinforce already extreme concentrations of advantage and disadvantage.

Import liberalisation is typically accompanied by wider reforms in domestic marketing systems, which again can have benefits for the poor. In the Indian State of Gujarat, licensing requirements for the collection of gum exclude women forest dwellers from participation in the market (SEWA 1997); removing them would generate potential benefits. However, even when State marketing systems create inefficiency, the reform of these systems can damage poor people’s interests. In Zambia, a government marketing board provided maize producers in poor areas with a guaranteed market and price. When it was privatised, market outlets collapsed, because there were no private traders to replace it. Competitive private markets are a requirement for protecting the poor from collusion between powerful traders, but such markets often do not exist.

No trade reform is gender-neutral. It follows that no trade policy should be designed without consideration of the potential outcomes on the distribution of income within households. The removal of barriers to women’s participation in rural markets, and the elimination of wage discrimination, would appear to be universal requirements for poverty reduction.

Bias against women means that trade-policy reforms can have unintended outcomes that are bad for poverty reduction. Although export production does not necessarily result in pressure on the food-crop economy, it can have this effect. Fieldwork undertaken in southern Zambia found that nutritional standards were suffering because of pressure on women to transfer their labour from food crops to cash crops (Oxfam/IDS 1999). More generally, commercialisation can result in women losing control over the marketing of cash crops, as has been reported in Uganda (Haddad 1995). As the majority food producers, women also face the most intensive pressure as a result of import liberalisation. Research in Ghana suggests that price pressures associated with increased food imports, the loss of extension services, and limited access to alternative markets have had adverse consequences on women farmers (Lumor 1999). In the case of Mexico, the increase in male migration associated with the demise of the maize sector has increased the workload of women and children (Watkins 1997). Replacing male labour on the home farm, while at the same time being forced by income pressures to spend more hours in off-farm employment, has placed acute stresses on women.

Designing pro-poor trade-reform policies: the role of Poverty Reduction Strategy Papers

As the evidence presented in this chapter and elsewhere in the report suggests, trade liberalisation is a policy which is neither inherently pro-poor nor anti-poor. Similar sets of policies could contribute to poverty reduction in one country, yet increase poverty in another (Morrisey 2001). By the same token, trade-policy reform can widen or reduce inequalities, depending on its design, pace, and sequencing. There are no blueprints for pro-poor trade reform, but there are some broad lessons. Ability to compete with imports and take advantage of export opportunities is partly a function of the distribution of productive assets. In countries with highly distorted patterns of asset and income distribution, failure to integrate redistributive strategies in
Box 5.3

How not to do a PRSP: the case of Cambodia

Poverty Reduction Strategy Papers (PRSPs) are supposed to place poverty at the centre of national reform programmes, breaking down the artificial division between social policies and macro-economic policies. While the concept behind PRSPs marks a step in the right direction, in terms of trade policy, application of the poverty-reduction principle has been haphazard.

Cambodia is one of the world’s poorest countries. Average incomes were estimated at only $268 at the end of the 1990s, with more than one-third of the population living below the poverty line. Poverty is most marked in rural areas. Poor rural people suffer from chronic under-investment in marketing infrastructure, irrigation, and basic services. Although economic growth has been strong, averaging over four per cent in the 1990s, rural poverty has fallen very slowly, at only 0.3 per cent a year. One reason for the weak link between growth and poverty reduction is that inequalities have been widening. Between 1993 and 1997, average income increased by 12 per cent. However, the income of the poorest one-fifth rose by less than 2 per cent, while that of the richest one-fifth rose by 18 per cent.

Under a succession of IMF programmes, Cambodia has embarked on a rapid trade-liberalisation exercise. Average tariff rates have been halved since 1996, to 15 per cent. Under the terms of two memoranda signed between the IMF and Cambodia in 2001, further reforms were introduced, including a sharp reduction in maximum tariff levels. One of the aims has been to prepare Cambodia for entry to the WTO.

Rice is one of the commodities that will be subjected to rapid liberalisation. This is the mainstay of the rural economy, accounting for more than 40 per cent of value-added. Most rice is produced under rain-fed conditions, which exposes farmers to risks from droughts and floods. Although Cambodia is self-sufficient in rice, with small export surpluses at the end of the 1990s, productivity levels and marketing costs are far higher than in either Thailand or Vietnam, the world’s largest and second largest exporters. How will import liberalisation affect small rice farmers in Cambodia, one of the biggest groups living below the poverty line?

The PRSP document prepared by the Cambodian government, under the auspices of the IMF and World Bank, does not even address this question. Instead, it simply asserts that increased openness will be good for growth, echoing the received wisdom on 19th Street in Washington. The omission is a serious one. Increased competition from lower-cost producers in Thailand and Vietnam would be expected to push down prices and restrict the market for Cambodian producers. While more commercial irrigated areas are in a position to withstand competition, only 12 per cent of rice farmers fall into this category. The combination of lower prices and reduced demand would have potentially grave consequences for poorer households, forcing them to seek alternative sources of income.

It could be argued that there is a free-market case for allowing cheap rice to enter the Cambodian market, given that neither Thailand nor Vietnam is a subsidising exporter. In terms of poverty-reduction strategies, current policy prescriptions raise serious problems of sequencing. With increased investment, support for infrastructural development, and increased provision of irrigation, it might be possible for most Cambodian farmers to compete with their counterparts elsewhere, or to diversify into other areas. Seeking to adjust through rapid trade liberalisation will have the effect of increasing both the social and economic costs experienced by rural Cambodians.

The PRSP for Cambodia has clearly failed to integrate trade policies into national poverty-reduction strategies. It has been guided instead by a blind faith in the virtues of open markets. An immediate requirement for reform is dialogue with farmers and research into the potential effects of market liberalisation on livelihoods.

trade reform will almost inevitably increase inequalities. Even if it is possible to combine rising inequality with poverty reduction, as in China and Chile, for example, widening income disparities act as a brake on the rate of poverty reduction.

The rapid development of inequalities associated with education has only one effective solution: extended access to education and improvements in education quality. For a country like India, the 50 million children denied access to school, and the 20 per cent enrolment gap in favour of boys, represent formidable barriers to poverty reduction. In Latin America, as shown in Chapter 3, education gaps are now the single biggest force that determines income-distribution patterns.

Import liberalisation can affect the ability of governments to finance and provide services that are vital to pro-poor growth. This is because revenues from import and export taxes represent an important source of State income in a large group of countries. One IMF survey of 36 developing countries found that trade taxes accounted for nearly one-third of tax revenue (Winters 2000). In Pakistan, revenue from customs duties fell by the equivalent of two per cent of GDP in the 1990s (Anwar 2000). Inevitably, losses on this scale make it more difficult to finance spending in areas that might enhance the ability of poor people to benefit from trade. As the main providers of care, women can be expected to suffer disproportionately from any cuts in public spending associated with revenue losses.

In terms of specific trade instruments, evidence suggests that there is a strong case for reducing taxes and regulations that impede poor people’s access to markets. With regard to import restrictions, more complex issues emerge. From a poverty-reduction perspective, what matters is the distribution of costs and benefits associated with the removal of such restrictions. This raises questions about sequencing and policy design. Restricting the importation of agricultural goods produced by the poor may be justified on social and economic grounds, especially if imports are subsidised. More broadly, in any labour-intensive sector it may make sense to delay import liberalisation until a wider range of complementary measures is in place, including improved infrastructure. Drastic and sudden trade liberalisation will not necessarily produce optimal outcomes, in terms of either sustainable growth or poverty reduction.

The starting point for the design of any trade-reform programme must be its integration into a broader national strategy for poverty reduction. In itself, trade liberalisation is not a poverty-reduction strategy, even if it can contribute to such a strategy. For all their recent commitment to ensure that macro-economic reform programmes are integrated into a wider set of policies for poverty reduction, neither the IMF nor the World Bank has applied this principle to trade policy. This is despite the development of Poverty Reduction Strategy Papers (PRSPs), documents that are supposed to set out in detail how IMF–World Bank programmes fit into national poverty strategies.

In a detailed review of 12 PRSPs, Oxfam found that only four even mentioned the possible impact of trade-reform measures on poverty. Of these, only two incorporated a policy response to mitigate the negative impacts of trade liberalisation. None offered even the most rudimentary assessment of the range of distributional outcomes that might result from import liberalisation, or reviewed alternative prescriptions for the pace, design, and sequencing of reform. This was despite the far-reaching liberalisation reflected in IMF–World Bank loan conditions. For example, in Cambodia the reform programme envisages large reductions in import protection for farmers in the rice sector. In a country with such high levels of rural poverty, located next to one of the
world’s lowest-cost rice exporters, this could have major implications for rural poverty (see Box 5.3).

The approach to PRSPs reflects a broader problem in IMF–World Bank thinking about trade reform. It is rooted in the received wisdom that trade is inherently good for growth and good for the poor. Until that is challenged, the new poverty rhetoric of the Bretton Woods agencies will remain at variance with the reality of their policies.

Trade liberalisation and growth: the limits to open markets

One of the ironies of the new consensus on trade liberalisation is that it identifies East Asia as an example of the virtues of openness. Yet the policies identified with openness were conspicuous by their absence from much of the region. The sustained growth associated with successful integration into global markets was the product of national policies that are far removed from those advocated today by the IMF and the World Bank. As the Trade Liberalisation Indicator illustrated, most countries in East Asia remain highly protected by international standards. Although there have been wide policy variations within and across countries, two common elements emerge, both of which have an important bearing on current debates.

The first concerns timing. Most countries in East Asia began to liberalise exports and provide export incentives before they started to liberalise imports. In broad terms, export liberalisation was pursued with far greater ambition than import liberalisation. Moreover, import liberalisation followed after countries had made the transition to higher economic growth, and after they had built up a strong base in education and economic infrastructure. Export growth provided an outlet for the productive potential unleashed through domestic reforms. In China, the reform programme started with the introduction of the household-responsibility system in 1979, under which farmers were able to market a larger share of their output. Export promotion followed, as government sought to generate the foreign exchange needed to provide the inputs for sustaining the reform programme, such as seeds, machinery, and fertiliser. In similar fashion, the foundations for Vietnam’s rapid integration into the global market were laid with the introduction in 1986 of Doi Moi, or the Economic Renovation programme. Farmers were allowed to increase sales to the market, and agricultural taxes were reduced, boosting agricultural productivity and income.

The second element uniting a large group of East Asian countries was a set of policies that, by today’s standards, would rank as highly unorthodox. They combined high levels of tariffs and non-tariff barriers with restrictions on foreign investment, and the imposition of domestic-content requirements on foreign firms. Assessed on their ‘openness’, Korea and Taiwan were, and remain, poor performers. World Bank analysis of price distortions associated with protectionism in the 1970s and 1980s found that both were more overtly interventionist than countries such as India, Brazil, and Mexico (Lall 1999). Countries such as Korea and Taiwan entered global markets after domestic firms had developed their capacity, with State support in an economic environment that was anything but open. Many of the policies used would be ruled out by IMF–World Bank loan conditions, or by WTO provisions (see Chapter 8).

East Asia used import protection as part of a strategy to raise technological capacity and productivity over the long term. There is no doubt that there were short-term costs: import barriers pushed up prices for consumers and producers. But the case of East Asia demonstrates that well-designed trade policies can create a dynamic comparative
advantage. In the 1950s, Korea’s fledgling steel industry would have been destroyed in open competition with its US counterpart; Taiwan’s electronic sector would have suffered the same fate in the 1960s. Today, it is the US steel industry and European electronics that seek protection from East Asia, rather than vice versa. Comparative advantage has been reversed.

Import protection is not a guaranteed route to more dynamic comparative advantage. The strategy of import-substituting industrialisation (ISI) pursued by most developing countries until the 1980s involved driving a wedge between domestic prices and world-market prices to shield local industries. As in East Asia, the idea was that domestic investment and technological capacity could be spurred by protection against imports. Some spectacular failures were recorded. In sub-Saharan Africa, whole industries proved to require more subsidies from the State than they produced in income. In India, highly capital-intensive, large-scale enterprises received unnecessary protection from foreign competition, driving up the costs of inputs to small and medium enterprises, and undermining efficiency and employment (Corbridge and Harriss 2000). For all this, ISI produced growth rates for some regions, including Latin America, which compare favourably with those recorded in the 1990s (Rodrik 2001c). In general terms, high levels of import protection, applied over a long period, are likely to produce inefficient industries. However, that does not undermine the case for using temporary and selective protection to nurture infant industries that could play a vital role in supporting higher growth and successful integration into global markets. Among the many rich ironies in current debates about trade is the fact that, for much of history, industrialised countries have been in the forefront of efforts to promote such industries through restrictive trade policies.

**Recommendations**

Through their influence over the design and implementation of IMF–World Bank policies, industrialised countries have been able to maintain a highly unbalanced process of trade liberalisation. Developing countries have been liberalising rapidly, incurring large adjustment costs, which have been compounded by the unwillingness of rich countries to open their markets. At the same time, the IMF and the World Bank have frequently undermined the ability of poor countries and poor people to integrate successfully into the global economy. Loan conditions that place a premium on rapid liberalisation, without proper consideration of the consequences for short-term poverty and long-term development, are among the factors that prevent trade from working for the poor.

Among the measures needed to address these problems are the following.

- **The removal of trade liberalisation from IMF–World Bank loan conditions.** The proper contexts in which to discuss reciprocal trade liberalisation are the WTO and regional trade agreements, which enable governments to exchange concessions. Apart from being badly designed and poorly sequenced, IMF–World Bank loan conditionality has severely disadvantaged developing countries.

- **Retrospective credit for past liberalisation undertaken by developing countries under IMF–World Bank auspices.** IMF–World Bank staff should undertake a full review of all unilateral trade-liberalisation measures undertaken under programmes...
supported by the two institutions over the past decade. These measures should be converted into tariff equivalents. They should then be reciprocated by the industrialised countries through negotiations at the WTO.

- **Poverty assessments under PRSPs.** All Poverty Reduction Strategy Papers should include a comprehensive assessment of the implications of trade liberalisation for poverty reduction and income distribution. These should be published as part of a national consultation process. The same principles should be applied by developing-country governments in their trade policies.