

# The Impact of Trade Liberalization on Poverty

*Summary of Proceedings from a Conference  
held on April 15, 2005*



Except where specified, the views expressed in this publication do not reflect the views of the U.S. Agency for International Development or the United States Government.

# ACRONYMS AND ABBREVIATIONS

<b>ACP</b>	African, Caribbean, and Pacific (EU program)
<b>AGOA</b>	African Growth and Opportunity Act (United States program)
<b>AIDS</b>	Acquired Immunodeficiency Syndrome
<b>CAFTA</b>	Central American Free Trade Agreement
<b>CBI</b>	Caribbean Basin Initiative (United States program)
<b>DDA</b>	Doha Development Agenda
<b>DDR</b>	Doha Development Round
<b>DFID</b>	Department for International Development, United Kingdom
<b>EU</b>	European Union
<b>FDI</b>	Foreign Direct Investment
<b>G-8</b>	Group of 8
<b>GDP</b>	Gross Domestic Product
<b>GNP</b>	Gross National Product
<b>IDA</b>	International Development Association (World Bank soft loan window)
<b>IBRD</b>	International Bank for Reconstruction and Development (World Bank commercial loan window)
<b>ILO</b>	International Labor Organization
<b>LAC</b>	Latin America and the Caribbean
<b>NAFTA</b>	North American Free Trade Agreement (Canada, Mexico, and the United States)
<b>NGO</b>	Non-governmental organization
<b>OECD</b>	Organization for Economic Cooperation and Development
<b>PROGRESA</b>	Programa de Educación, Salud y Alimentación (Education, Health, and Nutrition anti-poverty program in Mexico, now called Oportunidades)
<b>TCB</b>	Trade Capacity Building
<b>TRIPS</b>	Trade-Related Intellectual Property Rights
<b>U.N.</b>	United Nations
<b>UNDP</b>	United Nations Development Program
<b>USAID</b>	U.S. Agency for International Development
<b>U.S.</b>	United States
<b>WTO</b>	World Trade Organization

## ACKNOWLEDGMENTS

This report summarizes the proceedings of the conference, “The Impact of Trade Liberalization on Poverty,” which was held on April 15, 2005 in Washington, D.C. Organized by the Woodrow Wilson International Center for Scholars through grant funding from USAID and with significant financial support from the 3M Corporation, the conference addressed key issues relevant to poverty, development, and the Doha Round of multilateral trade negotiations.

This project would not have succeeded without the ongoing support and advice of USAID’s Borany Penh, who conceived of the idea for the conference. The Woodrow Wilson Center’s Kent Hughes, William Krist, John W. Sewell, and Lynn Sha worked tirelessly with Ms. Penh to turn the plan on paper into a substantive and meaningful program.

This conference report would not be possible without the dedication, skill, and hard work of USAID’s Don Sillers. Thanks are also due to John Ellis, Tim Mahoney, and Rick Marshall for their assistance in reviewing and facilitating the publication process.

Many individuals willingly gave up many hours for this project. They include: Alton Buland (Woodrow Wilson Center), Nicholas Cabiati (Duke University), Jacob Grover (Ohio State University), Jamie Merriman (QED Group, LLC), Anne Specca (QED Group, LLC), and Nan Zhang (University of California, Berkeley). Thank you.

## FOREWORD

I am pleased to present the proceedings of an April 2005 conference on Trade Liberalization and Poverty, sponsored by the U.S. Agency for International Development (USAID) and organized by the Woodrow Wilson Center for International Scholars.

Under President Bush's National Security Strategy, the United States Government promotes economic growth and economic freedom through more open international markets and trade. USAID is proud to be part of this effort. Assistance for trade capacity building is one of my top priorities and is an important complement to U.S. free trade initiatives.

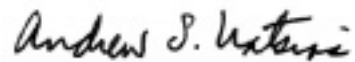
Opening up to world markets offers developing countries tremendous advantages, including access to growth-enhancing technologies, larger markets for the goods they can produce efficiently, and lower consumer prices for goods produced more efficiently elsewhere. In some cases, those imports include the staple foods that poor people depend on for survival. International trade and investment help raise developing country workers' productivity, the key to higher incomes and economic welfare. Recent research strongly confirms that freer trade boosts economic growth, the primary source of poverty reduction.

USAID is well aware of public controversy about the short- and long-term impacts of freer trade on poor countries and poor people. To shed light on some of these issues, the conference brought together leading scholars, journalists, and representatives from donor agencies and civil society for a frank examination of the most recent evidence and analysis. The panelists to the conference represented a wide range of views, resulting in discussions that were both lively and sophisticated. We hope that both qualities come through in these proceedings.

After carefully reviewing the evidence presented at the conference, USAID finds strong support for our belief that trade liberalization represents an essential part of a pro-growth, pro-poor development strategy. At the same time, we fully endorse the point emphasized by several panelists, that trade reform alone is not a panacea for reducing poverty. To maximize their gains from trade, countries must adopt complementary measures both to strengthen trade's contribution to growth and to enable poor people to take full advantage of the opportunities that growth creates. Many of those complementary measures are areas where USAID is already devoting a lot of effort: helping countries improve their educational and health systems; reducing regulatory barriers to creating new businesses and to workers finding new and better jobs; investing in agricultural technologies and rural infrastructure; and a wide range of efforts to help strengthen the impact of freer trade. Finally, USAID supports social safety nets to protect the livelihoods of workers who suffer transitional unemployment as a

result of trade liberalization or other economic change. We continue to work to improve the effectiveness of these programs.

On behalf of USAID, I would like to thank the leadership and staff of the Woodrow Wilson Center for their fine work in organizing the conference on which this document is based, as well as the 3M Corporation for providing additional support. Finally, I would like to extend a personal note of appreciation to the USAID staff who originated the conference and whose energy and enthusiasm were critical in making it such a valuable event.



**Andrew S. Natsios**  
Administrator  
U.S. Agency for International Development

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With more than two billion people living on less than two dollars a day, reducing world poverty is a moral imperative. In April 2005, the Woodrow Wilson International Center for Scholars, with sponsorship by the U.S. Agency for International Development, organized a conference to explore how trade liberalization can contribute to the reduction of world poverty. At the April conference, leading scholars, journalists, and policymakers engaged in a vigorous dialogue that helped clarify what is a complex and at times contentious debate.

The conference panelists and participants did find a positive link between trade and economic growth and an even stronger tie between economic growth and the reduction of poverty. But, the strength of the link often depended on other factors. The evidence presented at the conference suggests that the economic impact of trade liberalization increases when the right infrastructure and basic institutions are in place.

Despite overall gains from trade and growth, the conference stressed that there can be dislocations in parts of the economy that had been shielded from competition. Conference panelists called for a safety net for the poor that would maintain their access to health care and education.

The timing of the conference and the conference report were targeted at the ongoing Doha Round of multilateral trade negotiations. Most of the world's nations are involved in negotiations to reduce barriers to trade with the stated goal of contributing to growth in the developing as well as the developed world.

Ensuring that the poor receive an equitable share of the opportunities created by increasing trade and globalization is also important to the economic, health, and security interests of the United States. Our ability to protect Americans against communicable diseases such as avian flu would be strengthened by an improved capability of developing countries to prevent, detect, and treat such

sicknesses before they spread. Left unchecked, poverty also denies economic opportunities and can provoke conflict and terrorism.

“The overarching challenge of our time,” as Secretary Kofi Annan reminded us at the beginning of the 21st century, “is to make globalization mean more than bigger markets.” With the recent conclusion of the Hong Kong Ministerial of the WTO Doha Development Round, we must redouble our efforts to make trade a more effective instrument for the elimination of poverty.

I would like to express my personal gratitude to the Wilson Center’s Program on Science, Technology, America and the Global Economy for putting together this conference and volume. The United States Agency for International Development (USAID), under the able leadership of Administrator Andrew Natsios, was a terrific partner. The 3M Company also provided valuable assistance that was critical to the success of this project.

A handwritten signature in black ink, appearing to read "Lee H. Hamilton". The signature is fluid and cursive, with a large initial "L" and "H".

**Lee H. Hamilton**

President and Director

Woodrow Wilson International Center for Scholars

# EXECUTIVE SUMMARY

## SESSION I

The first two presentations examined the basic linkages between trade liberalization, economic growth, and poverty alleviation. Both panelists, Drs. Neil McCulloch and Ann Harrison, noted a paradox. There is strong evidence that economic growth normally reduces income poverty, and (somewhat more controversial) evidence that freer trade leads to faster economic growth. Together, these findings suggest that freer trade should reduce poverty, especially in the long run. But both presenters agreed that the available cross-country data provide no clear evidence that trade liberalization reduces poverty, at least in the short run.

To resolve this paradox, the first panelist reviewed evidence on the complex pathways through which trade liberalization can affect the poor, operating through price changes, employment impacts, and changes in government revenue and spending. Some critics of liberalization express concern that poor farmers will suffer if freer trade reduces the prices of staple foods. However, the evidence suggests that many (or most) of the poorest farmers are actually net buyers of staple foods, and so would benefit from lower prices of staple foods. Moreover, internal transport and marketing costs often insulate the poorest farmers in the most remote areas from changes in border prices.

Evidence on labor market impacts was mixed: wages and employment rose in some cases and fell in others. However, this panelist found the impact of freer trade on wages or employment to be “remarkably small.” Finally, the impact of reduced tariffs on the budget depends on many factors, including the initial share of tariff revenue in the budget. Governments can choose among various taxes to replace any revenues lost through trade liberalization; the choices they make can strongly affect the overall impact of trade liberalization on the poor.

Country context is important. In particular, the effects of trade reform on different sectors and different income groups depend on who initially benefited from trade protection, matters that vary from one country to another. Understanding how increased trade affects the poor requires both macro- and micro-level analysis. Even when the poor, as a group, benefit from trade, some will still face significant challenges. Identifying those who are most likely to suffer short-term harm can help policymakers design effective safety nets. However, policymakers should not use the need for complementary policies as an excuse to delay trade liberalization, as it can deliver a high “bang for the buck,” especially compared with other policy reforms.

The second panelist turned to country case studies for evidence on the impact of trade liberalization on the poor. Several case studies highlighted the fact that trade liberalization creates losers as well as winners, and in many cases the losers include substantial numbers of the poor. The studies also challenged a common belief that in countries with large populations of unskilled labor, the poor will necessarily benefit from reduced trade barriers. Those currently working in sectors that lose trade

protection are vulnerable to reduced incomes or job loss as a result of trade liberalization. The studies suggested that in many cases, such workers face serious barriers to finding new jobs in sectors newly advantaged by trade reform, whether because those sectors face additional barriers to expansion, or because of barriers to labor mobility. Also, developing countries can see strong gains from foreign direct investment (FDI); however, currency crises place disproportionate burdens on the poor.

These findings pointed toward a theme that recurred throughout the remainder of the conference: that countries that liberalize trade will often need to undertake complementary changes in other areas as well, in order to enhance the impact of trade reform, ensure that the poor fully share in the benefits, and minimize transitional income and employment losses for the poor. Examples of complementary measures cited included improved education; investments in rural roads and other infrastructure; support for agricultural research and extension; and the creation of effective social safety nets for the poor. Mexico's PROGRESA program is an excellent example of policies that helped boost education and health care for the poor, while ameliorating some of the challenges that can result from economic liberalization. Regarding labor markets, both panelists voiced strong support for core labor standards, but cited excessive minimum wages and stringent regulations on hiring and firing workers as serious barriers to hiring the poor.

The discussant, Bruce Strokes, expressed concern that the debate in Washington, D.C. over the Central American Free Trade Agreement (CAFTA) would center on the effects of the agreement on the United States instead of addressing the more significant impact of the agreement on Central American countries.

## SESSION II

The first panelist, Dr Thomas Hertel, summarized a set of simulations to identify the impact of trade liberalization on poverty at the national and global level. Two trade reform scenarios were examined: a "Doha Scenario" involving modest liberalization, and a more ambitious "Full Liberalization Scenario." The results confirmed that agricultural markets are currently the most distorted, and would be the most strongly affected by multilateral trade reform. This finding is especially important for the poor, because they spend a large share of their income on food and because many work in the agricultural sector.

One country case study suggested that countries such as Mexico, whose exports currently benefit from preferential access, may lose from multilateral trade liberalization, which would reduce the value of those preferences. A second found that the poorest farmers in Zambia would receive only small benefits as a direct result of higher global cotton prices resulting from reduced export subsidies, but that they would likely gain much larger benefits if complementary measures helped them switch into cotton production. A third study examined the impacts of global trade liberalization on regions within Brazil. The regions with the highest rates of poverty and unemployment would gain the most, while only a few well-off regions would be harmed; as a result, inequality would decline along with overall poverty.



Turning to the global projections, the projected near-term poverty impacts from the Doha Scenario are mixed, with increased poverty in some countries and reductions in others. On balance in this scenario, global poverty declines only slightly in the near term, but much more so over time. The more vigorous trade reforms assumed under the Full Liberalization Scenario were projected to produce much larger reductions in world poverty than would the more cautious reforms assumed under the Doha Scenario. Finally, the panelist noted that of all trade policy changes examined, the most poverty-friendly would be for developing countries to reduce their own high tariff rates, which currently pose severe barriers to the growth of South-South trade.

The second panelist, Dr. William Masters, attributed much of Africa's generally weak trade performance to agricultural and demographic pressures that have reduced poor farmers' ability to produce marketable surpluses. He attributed the initial decline of earlier decades to damaging trade and internal policies, but suggested that only research to develop improved crop varieties could reverse the negative trends.

The discussant, Dr. Caren Grown, outlined a number of ways in which women's unequal economic and social status undermines their ability to respond to opportunities and challenges that emerge in response to freer trade. For example, women in many poor countries lack access to productive assets like land and credit, a situation that reduces their ability to invest in new seeds, enter new markets, or otherwise take advantage of new opportunities. Similarly, women in poor countries generally bear the primary responsibility for family survival, which places heavy demands on their time and can make it difficult for them to respond to new opportunities.

## LUNCHEON

Sebastian Mallaby said that trade and globalization will only increase in the future and, on balance, this is good for global prosperity. He expressed deep concern about growing apathy towards international aid and development institutions. Countries must work to protect and strengthen existing institutions such as the World Bank. As trade increases in the future, it will become increasingly important to continue to support the winners and protect the losers. In those areas, multilateral aid and development institutions have a critical role to play.

International development institutions should not be viewed in the same way as private firms. The "shareholders" for these institutions are governments who have foreign policy concerns, environmental concerns, and many other issues that sometimes make it difficult for the institutions to maintain their focus on development.

## SESSION III

Four panelists, Dr. Theodore Antwi-Asare, Debapriya Bhattacharya, Rebeca Grynspan, and Rosario Guzman, examined the country and regional impacts of trade liberalization. In Ghana, trade and other reforms have spurred economic and

export growth. Poverty has declined in almost all parts of the country, but inequality has increased.

In Bangladesh, trade and financial liberalization have led to rapid growth in manufactured exports and female employment. Poverty has fallen steadily, but from high levels. Inequality has increased, partly due to barriers to absorbing rural-urban migrants into manufacturing jobs. The panelist identified several complementary measures to accelerate export and manufacturing employment growth, including further financial reforms and improved trade facilitation.

In Latin America, export growth within trade agreements has helped the region's economies recover in the 1990s after crisis and stagnation in the 1980s. However, the growth achieved has been disappointing, leading to political disaffection and resistance to further reform. High inequality and economic volatility have combined to increase the vulnerability of the region's poor.

Finally, a panelist argued that trade liberalization had contributed to the "production of poverty" in the Philippines, including high rates of unemployment, and bankruptcies among small and medium enterprises and small farms. She blamed lost tariff revenue for increased government budget deficits, increased foreign borrowing, and reduced ability to fund education, health, and other essential social services.

The discussant, Dr. Aseema Sinha, agreed that complementary policies, particularly in infrastructure and education, are needed to stabilize the losers and encourage the winners from trade liberalization. What kind of research needs to be undertaken to address the questions raised by the panelists? These studies should be complemented by comparative studies on similar and diverse developing countries.

#### SESSION IV

In the final session, representatives from bilateral and multilateral donor agencies and an international non-governmental organization (NGO) discussed ways to help countries reap the benefits of trade liberalization and ensure that the poor fully share in those benefits.

The panelists, Ruth Jacoby, Gawain Kripke, Kamal Malhotra, Peter Grant, and Walter North, recognized that the "complementary measures" highlighted throughout the conference are largely synonymous with a development agenda. Donor coordination, country ownership, and overall policy coherence on the part of donor nations were highlighted as good practices. Equally important are domestic reforms by developing countries, including investments in education and infrastructure, as well as improvements in governance.

Finally, the panelists all recognized that there are both winners and losers from trade reform, and suggested different approaches to help protect the poor from adverse shocks. They agreed that developed and developing countries had significant roles in helping the poor. Developing countries must gain more access to global markets, particularly in agriculture. At the same time, developing countries should make trade part of their overall agenda for economic growth and poverty reduction.

## SESSION I

### The Basic Links Among Trade, Growth, and Poverty

Chair: **Dr. Kent Hughes**

Director, Program on Science, Technology, America, and the Global Economy,  
Woodrow Wilson International Center for Scholars

**Dr. Kent Hughes** thanked the panelists for their participation in the conference, which would address key issues relevant to the Doha Development Round of multilateral trade negotiations.

He reminded the audience of the global commitment to halve poverty by 2015 and noted that international trade will undoubtedly play a growing part in the welfare of people in both rich and poor countries. The relationship between trade, economic growth, and poverty alleviation must therefore be thoughtfully examined and well understood by both policymakers and academics.

**Dr. Neil McCulloch**

Senior Poverty Economist, World Bank Group, Indonesia

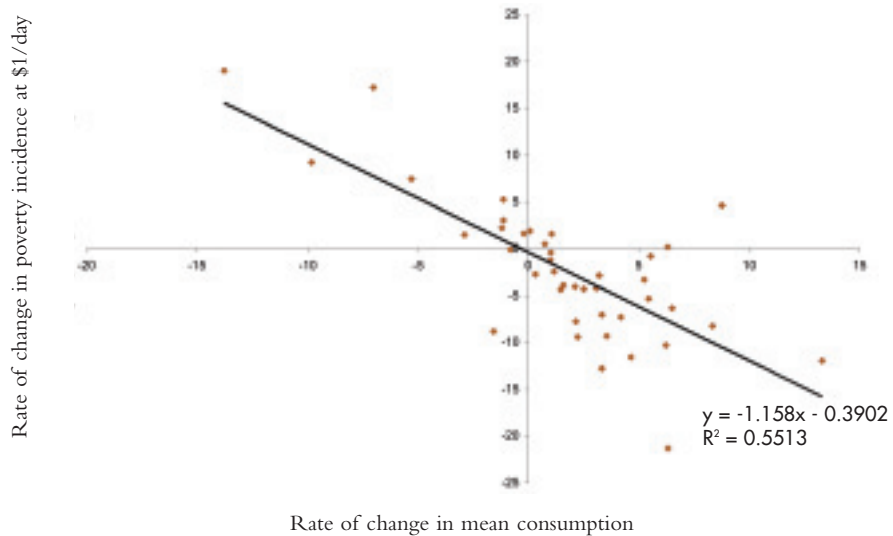
**Dr. McCulloch** began by noting that the connection between trade liberalization and poverty reduction is a highly contentious subject. While some argue that trade liberalization stimulates stronger economic growth, increased employment, and faster progress in reducing poverty, others maintain the exact opposite. Until recently, much of this debate has been based on assertion and anecdote, prompting Dr. McCulloch and his co-authors Dr. Alan Winters (University of Sussex) and Dr. Andrew McKay (University of Bath) to take a closer look at the empirical evidence.<sup>1</sup>

Dr. McCulloch identified two general approaches to the question of how trade liberalization affects poverty. The indirect approach tries to identify the impact of trade liberalization on economic growth, and then link this to evidence on the impact of growth on poverty. Empirically, the second part of this two-step chain is fairly well established—the literature shows that growth in average incomes and consumption accounts for a large share of observed

changes in the incidence of poverty. However, countries exhibit considerable variation around this average relationship, with growth producing greater reductions in poverty in some cases and smaller reductions in others. This variation has led to much effort to identify ways to make growth more pro-poor (Figure 1).

The immediate result of trade liberalization is to change the prices of different products at the border . . . Transport and marketing costs tend to insulate local markets from changes in border prices. In fact, local prices in remote rural areas, where many of the poorest people live, may be completely cut off from changes in border prices.

FIGURE 1 Growth is (Usually) Good for the Poor



Courtesy of David Dollar and Aart Kraay, World Bank

In contrast to the clear evidence on the positive impact of growth on poverty, it has been much more difficult to reach strong conclusions about the impact of trade liberalization on growth. In part, this reflects the difficulty of measuring the restrictiveness of overall trade policy, especially when countries use quotas, bans, and other quantitative restrictions as well as tariffs. In addition, the direction of causality is hard to establish: is openness to trade causing growth, or do growing economies simply become more open? Finally, trade liberalization is often introduced as part of a broader package of policy changes, making it hard to disentangle the growth impact of trade liberalization from that of other policy changes. Because of these and other difficulties, the impact of trade liberalization has been subject to vigorous and continuing debate. However, Dr. McCulloch concluded that on average, reducing trade barriers does promote economic growth.

In sum, most economists would agree that openness is good for economic growth, and that growth helps reduce poverty. But those conclusions are mainly relevant to the long run. It is equally important to assess the direct impacts of trade liberalization on poverty, including short-run impacts. To do this, Dr. McCulloch and his colleagues examined three pathways through which trade liberalization might affect the incomes of the poor, and assessed the empirical evidence on each pathway.

**Impact of changes in border prices on poor households.** The immediate result of trade liberalization is to change the prices of different products at the border. How those price changes affect the poor depends on whether poor households are net producers or consumers of the various products whose prices

have changed, and on how strongly border prices are transmitted to the poor in the first place. The first point is often ignored in debates over trade liberalization. For example, it is often assumed that if trade liberalization causes the prices of staple foods to fall, this must be bad for poor rural households. But in fact, in many cases the poorest farmers are actually net consumers of staple foods, buying more than they sell. In Indonesia, for instance, 80 percent of households are net consumers of rice, even though half of them are growing rice. For these households, a drop in the price of rice represents a net gain.

How strongly changes in border prices affect poor households is another complex issue. Transport and marketing costs tend to insulate local markets from changes in border prices. In fact, local prices in remote rural areas, where many of the poorest people live, may be completely cut off from changes in border prices. In that case, poor people living in those areas will experience no direct impact, either positive or negative, from any price changes caused by trade liberalization. Finally, in many countries, agricultural marketing boards insulate farmers from fluctuations in border prices, while taxing those farmers at the same time. The impact on the balance of costs and benefits for poor farmers from these policies is often hard to discern.

#### **Impacts on wages and employment.**

Two key questions are first, how trade liberalization affects wages and employment, and second whether transitional unemployment is concentrated among the poor. Dr. McCulloch's presentation focused on the first question. In theory, if wages

and prices are very flexible, trade liberalization will cause real wages to change but not affect the overall level of employment; the impact on the poor depends on how their wages respond to liberalization. In contrast, if wages and prices are very inflexible, trade liberalization will have more impact on the level of employment in different sectors and overall, versus the level of unemployment. The impact on the poor will depend on the direction and extent of these changes, and on the wages earned by the poor when they are employed versus their incomes when unemployed. In a country with a comparative advantage in exporting products that use a lot of unskilled labor, this theory would lead us to expect that trade liberalization will produce an expansion of output and increased employment in those unskilled labor-intensive industries. If so, that would certainly be good for the poor, because the empirical evidence has shown that moving into and out of employment is one of the major reasons for households moving out of and into poverty.

When Dr. McCulloch and his colleagues examined the available country case studies, they found a wide range of responses to trade liberalization, with total or

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manufacturing employment rising in some countries and falling in others; the same applied to real wages. As a result, it is very difficult to generalize about the impact of trade liberalization on either employment or wages.

However, the biggest surprise from the available studies is how remarkably small have been the impacts on wages, total employment, or sectoral employment. Greater caution might be advisable in countries where natural resources dominate exports, and thus do not have a comparative advantage in unskilled labor-intensive exports. In such cases, unskilled workers may not benefit from trade liberalization.

**Impacts on government revenues.** Many critics of trade liberalization express concern that it will deprive developing country governments of much-needed revenues. Out of 96 countries examined by Dr. McCulloch and his colleagues, import tariffs and other taxes on trade accounted for more than five percent of total revenues in 58 countries; in 16 of these, trade taxes contributed more

than 25 percent of total revenues. Thus trade liberalization will only have a negative impact upon revenues in countries where trade-related revenue is important. Even in these cases, the evidence does not show that trade liberalization generally reduces government revenues.

In fact, where initial tariff rates are very

high, reducing rates can cause tariff revenues to increase, as the volume of trade increases proportionally more than the drop in rates.

The same can happen in cases where trade liberalization involves shifting from reliance on quantitative restrictions to tariffs, so that a larger share of imports is taxed. Finally, in cases where tariff revenue does fall, other sources of tax revenue can be adopted. The thought and care that policymakers put into designing alternative sources of taxation makes a big difference, both in terms of the impact of trade liberalization on overall government revenues and in terms of its effect on the poor.

In conclusion, Dr. McCulloch emphasized that:

- There is no evidence that trade liberalization generally has an adverse impact on the poor, despite widespread disagreement with that conclusion.
- How trade reform affects poverty in any individual country depends on the country's specific circumstances and on the situation of its poor citizens. That requires going beyond macro-level generalizations and devoting serious analysis to the micro-level impacts on the poor.
- Even where poor households as a group benefit from trade liberalization, specific segments among the poor may suffer serious harm. The impact on different groups—both between the poor and the non-poor and among different sub-groups of the poor—partly depends on who benefits from the current form of trade protection. Identifying which groups are likely to suffer short-term harm can help in designing appropriate safety nets beforehand.

The thought and care that policymakers put into designing alternative sources of taxation makes a big difference, both in terms of the impact of trade liberalization on overall government revenues and in terms of its effect on the poor.

- Trade reform should not be viewed in isolation. Complementary changes will often be needed to enhance its impact and to ensure that the poor share in the benefits of trade liberalization.
- Finally, the need for complementary reforms should not be used as an excuse to avoid or indefinitely delay trade liberalization. Trade reform is an important part of a pro-poor development strategy, and moreover has a high “bang for the buck” compared with many other policy reforms, because it can be adopted relatively quickly and easily. As a result, it is important to strike a proper balance between getting the complementary policies right and actually taking advantage of the benefits of trade liberalization.

### Dr. Ann Harrison

Professor of Agricultural and Resource Economics,  
University of California, Berkeley

**Dr. Harrison** based her presentation on the major results from *Globalization and Poverty*,<sup>2</sup> a National Bureau of Economic Research book which she recently edited. When work on the book began, much had already been written about the relationship between globalization and poverty, but almost all was the work of journalists and other non-economists. Like Dr. McCulloch, Dr. Harrison described this work as largely anecdotal. The 15 papers contained in the book comprise some of the first efforts to apply economic analysis to the specific issue of globalization and poverty. The papers focus on two aspects of globalization: trade and financial integration through international capital markets.

Dr. Harrison began by reviewing data on recent trends in both globalization and poverty. On the first point, the world economy has become much more integrated in recent decades. Moreover, developing countries as a group have integrated much more rapidly than have the rich countries: over the past twenty years, the share of exports in GNP among the developing countries has doubled from 12.5 percent to 25 percent. Despite their strong “report card” on globalization, the developing countries continue to face ongoing pressure from the developed countries to open their markets further. The pace of financial market integration has also been quite rapid, though to a lesser degree than trade flows.

What has happened to global poverty in the meantime? The answer depends partly on the measure of poverty used. Considering first the *incidence* of poverty—the percentage of people living below a particular poverty line—an estimated 22 percent of the world’s population currently live on less than \$1 a day, while 55 percent live on less than \$2 a day. Those are large numbers, and the finding that more than half the world’s population lives on less than \$2 a day provokes shock and disbelief even among some development professionals. Nevertheless, they appear to be the best estimates available.<sup>3</sup>

Regardless of which poverty line is chosen, all analysts agree that the incidence of poverty in the world has been falling over time: measured against the \$1-a-day

line, poverty incidence fell from 40 percent to 22 percent over the two decades from 1981 to 2001. However, the trend is less clear in the case of the absolute *number* of people living in poverty. The best estimates suggest that there has been a slight decrease in the number of people living on less than \$1 a day, but a gradual increase in the number living under \$2 a day. Dr. Harrison described the poverty incidence measures as the standard measures of poverty trends, but noted that critics of globalization tend to focus on the absolute numbers to support claims that poverty has been increasing.

The incidence of poverty has fallen substantially over the past two decades, the same period in which developing countries have slashed tariffs and increased their trade shares. To what extent is increasing globalization responsible for the observed decline in the global incidence of poverty? To help answer that question, Dr. Harrison's own introductory chapter in the book examined both the indirect and direct links between openness and poverty.<sup>4</sup> Dr. Harrison agreed with both of Dr. McCulloch's conclusions regarding the *indirect* links between openness and poverty

[A] poor person initially working in a sector that loses protection and shrinks in the face of greater import competition will suffer as a result of trade liberalization creates losers as well as winners ... [U]nskilled workers in many countries face substantial barriers to finding new jobs ...

reduction: first, that the evidence strongly confirms that growth leads to poverty reduction, and second that there is strong and growing evidence that greater openness leads to faster growth. However, she stated that the cross-country data provide no *direct* evidence that trade reduces poverty.

How can these two conclusions be reconciled? Dr. Harrison cited two possible explanations: that the specific pattern of growth stimulated by greater openness is somehow bad for the poor, or alternatively, that the available data are simply too weak to provide a meaningful test of trade's impact on poverty. In particular, the small number of household surveys available for most poor countries over time provides too few data points to identify poverty impacts from trade based on cross-country evidence. To do that, one should instead rely on the kinds of country studies included in the book.

The findings of the case studies revealed enormous heterogeneity among countries in their responses to greater openness. However, some useful generalizations emerge:

First, the impact of trade liberalization on a particular poor person depends heavily on which sector that person was initially working in. A poor person working in an export-producing sector that expands in response to freer trade, or in a sector or region that receives increased foreign direct investment (FDI) because of greater financial market integration, will tend to benefit as a result. But just as importantly, a poor person initially working in a sector that loses protection and shrinks in the face of greater import competition will suffer as a result of trade reform. The evidence, she said, leaves no doubt that trade liberalization creates losers as well as winners.



Dr. Harrison described as “totally wrong” the orthodox notion that globalization must be good for the poor in countries with a lot of unskilled labor, based on the assumption that workers will be able to move from sectors that are shrinking in response to reduced protection to new sectors that are expanding because of increased demand for exports. In fact, unskilled workers in many countries face substantial barriers to finding new jobs, a problem documented in several case studies contained in the book. Moreover, for sectors to expand in response to changed signals from the world market typically requires both access to additional skilled labor as well as improvements in many complementary policies.

Turning to financial integration, Dr. Harrison cited evidence from the country case studies that FDI generally benefits the poor. In contrast, poor households suffer disproportionate losses from currency crises. Therefore, countries that choose to integrate more fully with international financial markets should be careful to do so in a way that minimizes the risk of a subsequent currency crisis.

Dr. Harrison made two general points in closing. First, she cited examples of the kinds of complementary policies that can be adopted along with trade reform to ensure greater gains for the poor. Measures that help workers relocate and gain jobs in expanding sectors can reduce the problem of immobility. Improved education can help fill expanding sectors’ need for better-educated workers. Farmers need access to complementary inputs to move from subsistence farming to producing for international markets. Countries need improved institutions to benefit from global financial integration and to be protected from its risks.

Second, Dr. Harrison reiterated that there are losers from trade reform as well as winners. As a result, targeted compensation for losers can be important to ensure that the benefits from reform are broadly shared; she cited Mexico’s PROGRESA program, (an initiative by the Mexican government targeted at the rural poor to develop their human capital by paying families to send children to school and regularly see health care providers) as a good example. Finally, Dr. Harrison emphasized that improved access to the markets of the developed countries is essential to ensure that poor countries benefit from trade liberalization.

### Bruce Stokes

Trade and International Economics Correspondent, *National Journal*

**Mr. Stokes** began by acknowledging the complexity and quality of the evidence presented by Drs. McCulloch and Harrison. This contrasted favorably with many other presentations that often simplified the relationship between trade and poverty for journalists and policymakers with “bumper-sticker answers.”

Mr. Stokes reviewed some pertinent findings from the Pew Global Attitudes Survey, in which he is involved. In the 44 countries included in the survey, people almost everywhere said that their lives had gotten worse over the past five years; in 30 of those countries an overwhelming majority said that inequality was increasing. However, in neither case did many people attribute those perceived

changes to globalization. Rightly or wrongly, people typically do not blame globalization for their problems.

Mr. Stokes asked whether the finding in Dr. Harrison's book that people in export-producing industries and regions typically gain from trade liberalization, while those in import-competing industries and regions often lose, confirmed the East Asian trade model (in which countries try to get unilateral access to markets in the industrialized countries, while maintaining restricted access to their own markets)? Would that approach help countries make faster progress in reducing poverty?

Second, Mr. Stokes noted two different responses to the conclusion that inflexible labor markets reduce the benefits that poor people derive from trade liberalization. Conservatives and the business community might endorse that conclusion as a rationale for weaker enforcement or even elimination of labor laws, as well as for getting rid of unions. In contrast, the left could view the same finding as confirmation of the claim that the only way to benefit from trade is to allow workers to be exploited. How should labor laws be structured? Is a "flexible labor market" simply one in which labor unions are kept down?

Third, Mr. Stokes asked the presenters to identify which complementary policy they viewed as the most valuable in ensuring that the benefits of trade liberalization are broadly shared. Should there be more money for safety nets? Should countries adopt labor adjustment assistance programs, like those the World Bank has been exploring to facilitate adjustment to changes in world textile markets? What kinds of policies will help ensure that trade liberalization leads to a reduction in poverty?

Finally, Mr. Stokes asked Dr. McCulloch to expand on his point that one of the virtues of trade liberalization is that it can be adopted by fiat. Shouldn't that alert policymakers to the danger that, despite the importance of adopting complementary policies along with trade reform, the relative difficulties posed by those other policies means that they might never be adopted at all?

In response to the question regarding East Asia's trade strategy, Dr. Harrison emphasized that East Asia's success involved a lot more than trade: it required strong and responsible government, stable macroeconomic policies, and a huge emphasis on education and investment. In addition, the region's successful strategy of pursuing export-led growth requires a strong institutional capacity to identify and support emerging winning industries and to refrain from protecting losers. Many countries that have tried to replicate the Asian model, particularly in Latin America, have ended up hurting themselves rather than helping.

Regarding labor market flexibility and regulations, Dr. Harrison first distinguished between immobility created by laws and that arising from tradition. The case study of Poland highlighted labor immobility, but ascribed it to Polish workers' distaste for moving. In other cases, government regulations create immobility, for example by making it very costly for firms to fire workers. Similarly, in Indonesia, very high minimum wages discourage employment and push workers into the informal sector. On the other hand, Dr. Harrison voiced strong support

for workers' right to form labor unions, which can play the same role in developing countries as they did in the United States: ensuring that workers get higher wages and decent working conditions. She credited anti-sweatshop campaigns by non-governmental organizations (NGOs) with achieving greater fairness in sharing the benefits of globalization.

Regarding complementary policies, Dr. Harrison cited improvements in education as especially important, given the dismal state of education in many poor regions. Investment in AIDS prevention and health and in infrastructure is critical.

Dr. McCulloch agreed that the East Asian model had been very successful, but doubted that seeking expanded access to foreign markets while keeping one's own markets closed could be a successful negotiating strategy for developing countries in the Doha Round. He also agreed that East Asia's success involved much more than simply pushing exports while restricting imports.

Turning to labor markets, Dr. McCulloch found absolutely no reason not to support the International Labor Organization's (ILO) core labor standards; despite the claims of some East Asian countries that implementing those standards might constrain their growth, there is absolutely no evidence that this is the case. However, labor regulations that make it difficult for workers to move from one job to another are very damaging for the poor. If, as in Indonesia, a firm must pay two years' wages as compensation before firing a worker, it becomes much costlier for firms to shed labor in response to lost protection, and deters workers from moving to growing sectors. This kind of labor market inflexibility is also seen in Dr. Harrison's case studies. A flexible labor market that helps workers move from declining to growing sectors helps spread the benefits of trade reform.

[D]espite the claims of some East Asian countries that implementing [ILO core labor standard] might constrain their growth, there is absolutely no evidence that this is the case.

Finally, minimum wages are important to protect workers from being exploited, but they should be set according to the local income distribution rather than to wages in developed countries. In setting minimum wages much too high—six times the local poverty line—Indonesia creates a huge disincentive to employ the poor.

Dr. McCulloch agreed that labor unions could play an important role as civil society actors, promoting broad issues like democracy and better governance. Many unions in developing countries are very responsible, such as in Indonesia where they play an active role in developing the Poverty Reduction Strategies. Unfortunately, in many countries unions focus narrowly on the interests of formal sector workers, who tend to be much better off than the poor.

Should workers who lose their jobs because of trade liberalization receive social assistance? In principle, yes, said Dr. McCulloch. However, only the United States offers comprehensive trade adjustment assistance, and its effectiveness has been widely criticized. Countries should not design social safety nets for specific kinds of shocks, e.g. compensate workers who lose their jobs because of trade-related

shocks but not those who lose their jobs for other reasons. In developing countries what is needed are social protection programs that reach the poor, most of whom work in the informal sector and live in rural areas. Such a focus may create tensions with unions, who are typically more interested in social protection for the formal sector, usually meaning urban workers.

Finally, if countries really want effective complementary policies, they should not spend all their money on social protection. They should build roads.

## QUESTIONS, ANSWERS, AND DISCUSSION

**Question:** What kinds of taxes should a country like Ghana use to replace the tariff revenues lost through trade liberalization?

Dr. McCulloch responded that countries can choose among many different kinds of replacement taxes, including taxes on consumption (sales or value-added taxes), on income, or on capital. All the empirical evidence confirms that the choice of replacement taxes can critically affect the overall impact of trade reform on the poor. To maximize benefits for the poor, developing countries must consider the impacts of different replacement taxes on both growth and distribution. Some critics are concerned that governments will replace trade taxes by turning to the easiest and highest-yielding form of taxation, which usually means taxing staple foods. Such a policy would virtually guarantee a regressive impact, especially on the poor. But few countries earn such a large share of government revenues from trade taxes that they would need to adopt such regressive forms of replacement tax. They almost always have better alternatives.

[R]oads and agricultural extension services are two of the most important examples of complementary policies. China and Indonesia have been the most successful examples of poverty reduction in the last 30–40 years. In both cases one of the keys to success has been the dissemination of agricultural technology through extension services, which proved to be critical to ensuring that growth benefited the poor in rural areas.

**Question:** Much of the discussion has involved mobility for unskilled labor, but what about the movement of skilled labor from developing countries to rich countries, which causes the former to lose the investments they have made in those higher skills?

Dr. Harrison noted that in countries that receive a lot of remittances from emigrant workers, labor's share of total income is rising as a result. Rich countries could help reduce the problem of permanent "brain drain" by reducing restrictions on movement back and forth to immigrants' home countries. Developing country reforms can also create opportunities that encourage former emigrants to return home. For example, many skilled Indians have returned to India in the wake of reforms that allow them to set up companies there. Developing countries should also be spending a larger share of their educational budgets on primary and secondary schooling and stop subsidizing university education. That would allow them to increase their base of

skilled workers and also help reduce the number of highly educated emigrants leaving with degrees from state-subsidized universities.

**Question:** Shouldn't agricultural and industrial extension services be recognized as essential complementary policies?

Dr. McCulloch responded that roads and agricultural extension services are two of the most important examples of complementary policies. China and Indonesia have been among the most successful examples of poverty reduction in the last 30–40 years. In both cases one of the keys to success has been the dissemination of agricultural technology through extension services, which proved to be critical to ensuring that growth benefited the poor in rural areas. The declining share of spending on technology dissemination—especially to agriculture—should be reversed.

**Question:** Where is the evidence that food-importing countries benefit from OECD export subsidies?

Dr. Harrison responded that while some people claim that the United States has been dumping maize on Mexico and thereby devastating poor farmers, a paper in her book by Dr. Margaret McMillan (Tufts University) reveals that the poorest farmer households in Mexico actually consume more maize than they grow, so the poorest of the poor benefit from the lower maize prices caused by imports. The opposite is true for less-poor farmers, who grow more maize than they consume.

**Question:** Shouldn't poor countries build up their domestic industries and agricultural sectors before exposing them to competition?

Dr. Harrison acknowledged the possibility that countries might suffer harm on balance if they allow “infant industries” to be eliminated by exposing them to competition from imports, but noted that the evidence on this issue is not yet clear.

Mr. Stokes closed by lamenting that the forthcoming debate in Washington over the CAFTA treaty would revolve almost entirely around impacts on the United States. More attention should be focused on the effects of CAFTA on Central American countries, which he predicted would dwarf the treaty's effects on the United States.

## SESSION II

### How the Poor Respond to Opportunity and Adversity

Chair: **Borany Penh**

Political Economist, Poverty Analysis and Social Safety Nets Team,  
U.S. Agency for International Development (USAID)

**Ms. Penh** began by noting the need for more research on the complex linkages between trade liberalization and poverty reduction and asked if alternatives to the orthodox model should be explored. Session I demonstrated that trade liberalization affects different groups in different ways. Part of understanding why this is so requires the examination of the conditions that prevent the poor from taking advantage of new trade opportunities, while keeping in mind that “the poor” are not a homogenous group and that some groups, like women, face greater challenges to participating in the economic process.

Dr. **Thomas Hertel**

Professor, Purdue University, and Visiting Scholar, World Bank

**Dr. Hertel** based his presentation on a World Bank research project he has co-directed with Dr. Alan Winters, seeking to identify the impact on poverty of the Doha Development Agenda (DDA) currently being negotiated in Geneva.<sup>5</sup> His presentation focused on agriculture, which he described as one of the most distorted areas of the international economy and one of the most difficult in which to achieve reform. Agriculture has a strong bearing on poverty reduction, because the poorest households tend to be heavily dependent on agriculture as a source of income and also spend a large share of their income on food, making them especially vulnerable to increases in food prices.

The research project used two different scenarios for the potential outcomes of the negotiations and conducted 13 country case studies drawn from Africa, Latin America, and Asia. The case studies applied a common analytical framework, distinguishing between long-term and near term impacts of trade liberalization.

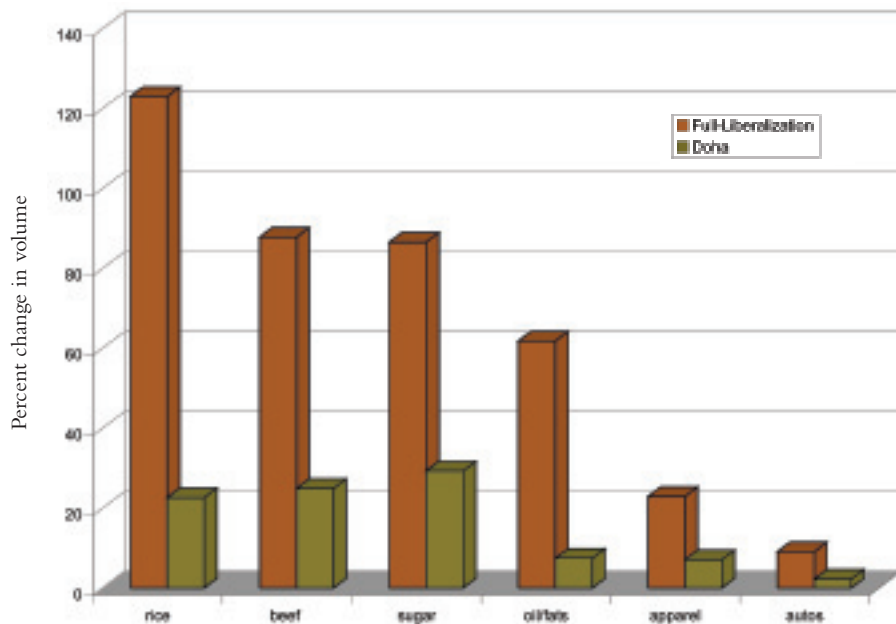
Economic growth is the only way to achieve sustained poverty reduction in the long run. On the other hand, much of the debate about globalization and poverty focuses on the near term. As emphasized in the first session, globalization is clearly going to produce both gainers and losers in the near term. The key question is, will the *poor* be among the gainers or the losers? Or if some poor people gain and others lose, where do things come out on balance? And, if the poor are at risk in the short term, what can be done to minimize those short-term transition costs and maximize the potential for long-term gains to the poor?

Drs. Hertel and Winters based their analysis on two alternative scenarios of trade reform: a “Doha Scenario,” which embodies detailed assumptions about the

policy changes that might emerge from relatively moderate trade liberalization, and as an alternative benchmark, a “Full Liberalization Scenario,” in which all tariffs, export subsidies, and domestic agricultural support would be eliminated. (Assumptions for the “Doha Scenario” were discussed with actual negotiators, who confirmed their realism as negotiations currently stood.) Next, their team projected the impacts of the trade policy changes assumed under each scenario on global markets, including world prices and trade volumes of major food and agricultural commodities as well as automobiles and apparel. The results of both projections confirmed that agriculture would be the sector most strongly affected by trade liberalization. The results of these two projections were then fed into the country case studies to assess country impacts, including impacts on the poor (Figure 2). The country case studies confirmed that the degree to which border price changes are transmitted within countries strongly affects their impact on households living in different regions. Dr. Hertel saw this as a fundamental issue in the trade and poverty debate.

For example, vigorous trade reforms carried out by Mexico in the 1990s yielded substantial welfare gains for households in states close to the U.S. border, whereas households in the southern states received few if any benefits.<sup>6</sup> The analysis suggests that Mexico would lose from the Doha Development Agenda, because Mexico would lose the preferential access to the U.S. market it currently enjoys

**FIGURE 2** Projected Impact of Trade Reforms on World Exports  
(% change in volume)



Courtesy of Thomas Hertel, Purdue University and World Bank

under NAFTA. Any agreement that cuts U.S. tariffs for other countries would erode the value of Mexico's preferences. Mexico offers an extreme case, but the same issue of potential preference erosion under the DDA applies to the preferences for least-developed countries under the U.S. African Growth and Opportunity Act (AGOA) and Europe's "Everything But Arms" initiative.

Further analysis suggests that the poorest farmers in Mexico's northern and border states would receive very modest benefits under the Doha Scenario, because they are net sellers of products whose prices would rise; poor farmers in other states would be largely unaffected

because of their insulation from changes in border prices. Efforts to boost productivity through better extension services would help the first set of farmers respond more fully and derive bigger income gains. In contrast, southern

farmers would remain unaffected unless investments in roads and improved marketing institutions helped better transmit the opportunities created by increased border prices to those regions. This analysis strongly confirms the importance of complementary investments to maximize potential gains against poverty.

A second case study, covering Zambia, also highlights how complementary domestic reforms can affect the potential gains for the poor from the DDA.<sup>7</sup> After privatizing the cotton marketing board in 1994, the Zambian government launched a program to lend seed and fertilizer to the poorest farmers to help them start growing cotton. This effort substantially increased the income these farmers derived from cotton. One lesson is that in order to gain from higher world prices, the poorest farmers must be in a position to produce the affected crops. The analysis suggested that the higher cotton prices projected under the Doha Scenario would boost incomes among Zambian subsistence farmers a mere one percent, whereas much larger income gains would be achieved by enabling more of these farmers to grow cotton (20 percent) and through better extension services to boost their productivity (eight percent.)

A third case study covered Brazil, a country that would reap major benefits if the Doha negotiations result in a liberalization of OECD agricultural policies.<sup>8</sup> The study applies data from household surveys in Brazil to examine the concern that those gains would mainly flow to rich farmers, further worsening Brazil's highly unequal income distribution. The study reaches just the opposite result, concluding that the Doha Development Agenda would produce large reductions in poverty and unemployment in those regions with the highest incidence of poverty, largely through its impact on agriculture. In contrast, poverty and unemployment are projected to increase in only a few mainly industrial regions, which currently have the highest incomes and lowest incidence of poverty. In sum, the DDA is likely to reduce inequality in Brazil, but that only becomes clear through detailed examination of likely winners and losers. In all cases, the direction of the

[The Doha Development Agenda] is likely to reduce inequality in Brazil, but that only becomes clear through detailed examination of likely winners and losers.



projected regional changes in poverty and unemployment are the same under the Doha and Full Liberalization Scenarios, but larger in magnitude under the latter.

Turning briefly to labor markets, Dr. Hertel cited evidence from China that confirms that education plays a key role in promoting labor mobility, as suggested in the first session. In particular, the study found that greater educational attainment

[E]ducation plays a key role in promoting labor mobility ... [G]reater educational attainment strongly facilitates mobility from agriculture to non-agriculture, often an avenue for poverty alleviation.

strongly facilitates mobility from agriculture to non-agriculture, often an avenue for poverty reduction. One additional year of schooling was found to boost a worker's chance of finding non-farm employment by 14 percent.<sup>9</sup>

Summarizing the full set of case studies, Dr. Hertel stated that the near-term impacts on poverty from trade liberalization as embodied in the less "ambitious" Doha Scenario are mixed, with projected increases in poverty in some countries and declines in others. Globally, the studies projected a modest near-term reduction in poverty from trade liberalization

(Figure 3). In contrast, the few studies that have focused on the long run find that the growth impact of trade liberalization under this scenario will lead to an unambiguous decline in world poverty over time (Figure 4).

The Doha Development Agenda must be ambitious to affect development, a point especially relevant for trade negotiators from the developing countries ... [T]o achieve a strong impact on poverty reduction through faster growth, trade reform will need to be more comprehensive than is currently envisioned by many members of the World Trade Organization.

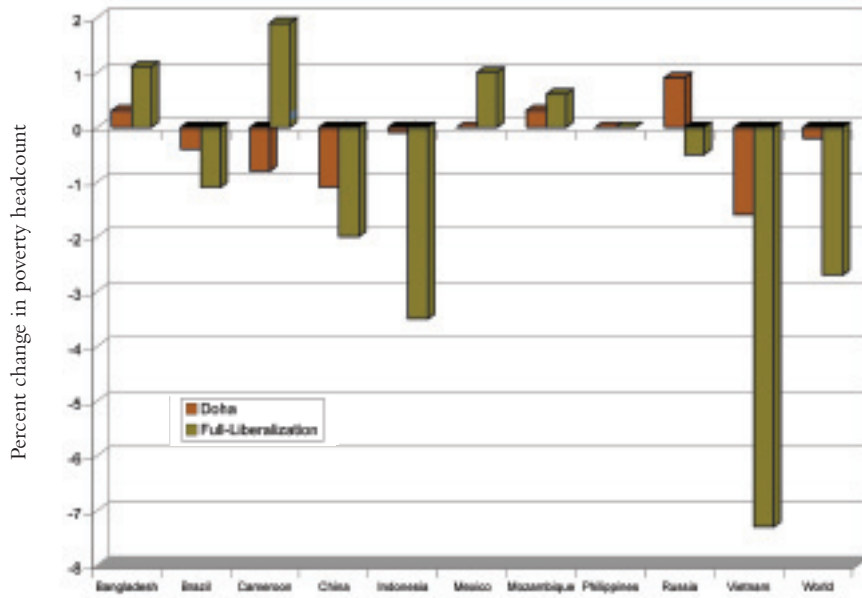
In terms of policy conclusions, the case studies found that the Doha Scenario is less poverty-friendly than it could be, especially compared with the Full Liberalization Scenario. As currently negotiated, the Doha Scenario emphasizes some aspects of liberalization

at the expense of others: Doha emphasizes reductions in export subsidies and domestic subsidies, while downplaying measures to expand market access, particularly tariff cuts by the developing countries. Larger tariff reductions by developing countries than those assumed under the Doha Scenario would produce much stronger and more general reductions in poverty.

Dr. Hertel concluded with the following points:

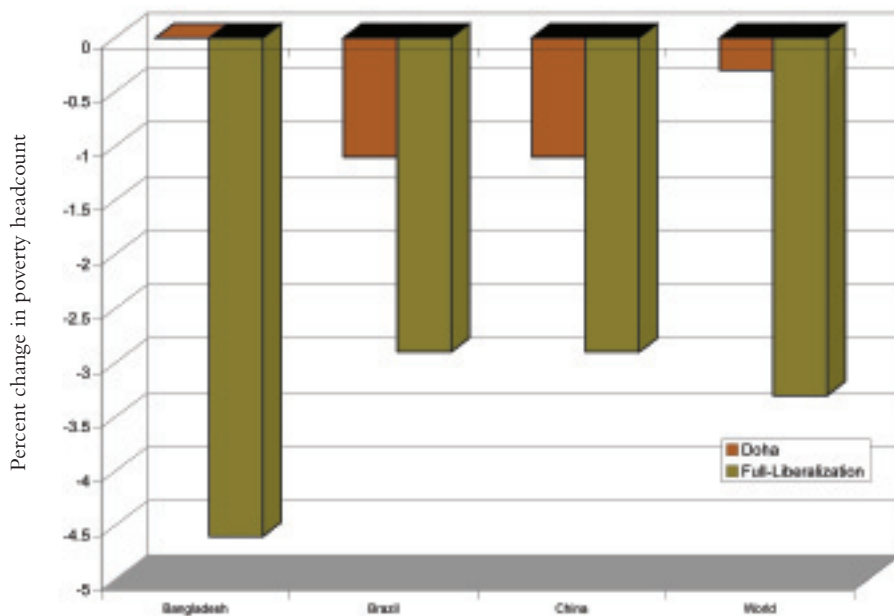
- The Doha Development Agenda must be ambitious to affect development, a point especially relevant for trade negotiators from the developing countries. In particular, to achieve a strong impact on poverty reduction through faster growth, trade reform will need to be more comprehensive than is currently envisioned by many members of the World Trade Organization (WTO), who for example are devoting relatively little attention to reform of trade in services.
- The impacts on poverty of the trade policy changes embodied in the Doha Scenario would likely be mixed in the near term, though slightly positive on

**FIGURE 3** Projected Near-Term Poverty Impacts of Trade Reform are Mixed



Courtesy of Thomas Hertel, Purdue University and World Bank

**FIGURE 4** Long-Term\* Poverty Impacts of Trade Reform are Uniformly Favorable



\* Includes impact of liberalization on investment

Courtesy of Thomas Hertel, Purdue University and World Bank

balance; impacts would be larger and more widespread in the long run.

- Proposals to allow rich countries to exempt “sensitive” agricultural products from steep tariff reductions, while allowing developing countries to exempt “special” products from similar tariff cuts, would greatly undermine the poverty impact of the DDA.
- Complementary domestic reforms are required to ensure significant reductions in poverty in the near term.

### Dr. William Masters

Professor of Agricultural Economics, Purdue University

**Dr. Masters** focused his presentation on Sub-Saharan Africa, the only major region of the world with a rising number of very poor people. He noted that Africa’s continued impoverishment is often attributed to a lack of trade, and that

As productivity has stagnated and population has increased, malnutrition among both young children and adults has increased in Africa . . . In turn, malnutrition greatly reduces people’s resistance to diseases.

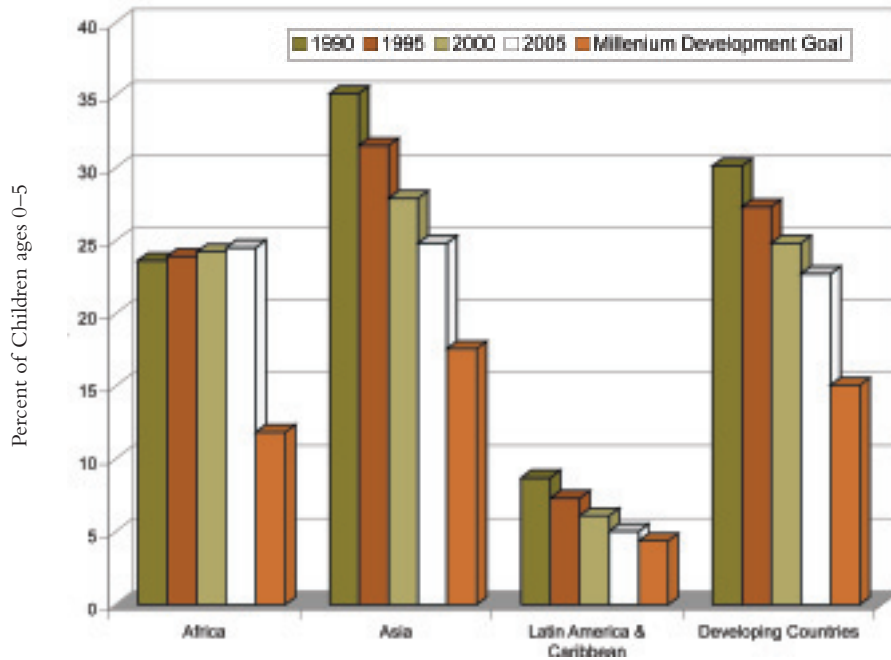
trade is indeed closely correlated with poverty alleviation. But Dr. Masters emphasized that the causality involved is complicated, because other factors might be limiting productivity and thereby constraining both trade and growth. If so, interventions aimed at

those underlying constraints might be needed. Without such interventions, trying to alleviate poverty by expanding trade might be impossible, and could be likened to trying to raise a balloon by pushing on its string.

To help target interventions towards the underlying causes of low trade and worsening poverty, Dr. Masters focused on the interaction between peoples’ nutritional needs, the pace of population growth, and their opportunities for non-farm employment. He argued that even with rapid growth in non-farm employment, the initial size of the non-farm sector in Africa has been too small to absorb all of the continent’s rural population growth, leaving the region with the world’s fastest and longest sustained increase in the number of farmers. With an ongoing decline in available land per farmer, households have had to devote a rising fraction of their resources to meeting nutritional needs. Dr. Masters argued that this “arithmetic of rural population growth” has exerted an unprecedented degree of downward pressure on African incomes, to which governments and aid donors have not responded with enough investment in locally-appropriate new agricultural technologies.

Dr. Masters argued that Africa’s farmers have responded to their circumstances much as other farmers would, accumulating assets in good times and drawing them down in times of adversity. The major physical assets for African farmers are livestock and soil quality, which can either be improved or allowed to deteriorate if nutrients are not replenished. Human capital is an even more important asset. Health and nutritional status, a form of human capital, is closely linked to labor

FIGURE 5 Data on Childhood Underweight, 1990–2005



United Nations Standing Committee on Nutrition (2004), *Fifth Report on the World Nutrition Situation*. New York: United Nations Standing Committee on Nutrition.

productivity. Most poor Africans are now living at or near the nutritional floor, below which their health suffers serious damage. Decisions regarding how many children to have and how much to invest in each child crucially affect households' prospects for emerging from poverty. In addition, during times of adversity African farmers fall back on social capital as opposed to markets, choosing to live where they can tap into networks of social insurance among their kin and ethnic groups. As market opportunities shrink, the chances of earning a living outside these networks become very poor. Similarly, as worsening conditions have forced more people toward the nutritional floor, cooperation between farmers and herders has progressively declined and conflict over resources has grown sharper.

Dr. Masters presented data pointing to low and stagnant fertilizer use as a particularly important symptom of Africa's low productivity trap.<sup>10</sup> Since the debt crisis of the early 1980s, Africa's inability to borrow in order to import fertilizer, combined with a lack of fertilizer-responsive plant varieties, has kept fertilizer use per hectare below ten percent of that in South Asia. As productivity has stagnated and population has increased, malnutrition among both young children and adults has increased in Africa, while declining in other regions. In turn, malnutrition greatly reduces people's resistance to diseases. Children suffer the most,

because malnutrition prevents them from building the body mass they need to survive infectious and parasitic diseases (Figure 5). Their low productivity forces the poorest African farmers to be net buyers of basic foods, and net sellers of other products such as livestock, oilseeds and tree crops. Moreover, because cities are better linked than rural areas to the transportation networks handling food imports, poor farmers face higher food prices than do urban households, contributing to their relative poverty and malnutrition.

In conclusion, Dr. Masters focused on low food-crop productivity growth as a key constraint on both trade and poverty alleviation in Africa, relative to South and East Asia. He blamed the highly restrictive trade policies and heavy taxation of agriculture formerly imposed by African governments for the decline in regional food output per capita beginning in the mid-1970s. Subsequent trade reforms have merely stabilized food production per capita at a very low level. To outpace rural population growth, much greater investment in productive public goods would be needed, particularly in the development and spread of the locally-appropriate crop varieties needed to raise the payoff from farmers' land, labor and other investments. Public investment in such agricultural technology was much delayed in Africa relative to Asia, and has remained low. The investments that have been made have generated high rates of return, but significant investment in food-crop improvement did not begin until the 1970s and remains far below the levels needed to keep up with rural population growth.

Dr. Caren Grown

Poverty Reduction and Economic Governance Team,  
International Center for Research on Women

**Dr. Grown** noted that the panel had further enriched the day's discussions by using country cases and microeconomic and household data to tease out the impact of trade liberalization on the poor. Both of the first two panels stressed the heterogeneity of responses by different groups

of the poor; spatial differences between the urban and rural poor had received special attention. In contrast, the social dimensions of poverty had not been discussed. Racial and ethnic minorities and low-caste people are disproportionately represented among those below the poverty line; policymakers must look for ways to enable such groups to take better

advantage of the opportunities created through trade liberalization.

Dr. Grown cited gender, the socially determined roles and expectations of males and females, as another type of difference that is important in understanding the trade-poverty nexus. She was pleased that gender appears in the analytical

Especially in Africa and South Asia, men often constrain women's employment and control the income women earn. These constraints reduce women's incentives and may help explain the weak supply response to trade liberalization seen in African agriculture.

frameworks presented, but urged that it be carried through to the actual analyses. Gender-related issues include:

- The impact of trade liberalization on the distribution of income and employment among different social groups, including men versus women. Women's consumption patterns are different from those of men, which again raises the question of differential impact. If liberalization leads to reduced tariff revenues, women may be affected differently either by reductions in social spending or by the choice of replacement taxes.
- Women are more vulnerable to chronic poverty because of gender differences in the distribution of income and by lack of access to productive assets like land and credit. Those constraints may reduce women's ability to invest in new seeds, enter new markets, or otherwise take advantage of the opportunities created by trade liberalization.
- Especially in Africa and South Asia, men often constrain women's employment and control the income women earn. These constraints reduce women's incentives and may help explain the weak supply response to trade liberalization seen in African agriculture.
- Complementary policies of particular importance for women include access to secondary education, stronger property and inheritance rights, and access to credit markets.

Dr. Grown concluded by asking about the degree of policy space available to the developing countries. If we reject the notion that "one size fits all," does the current international system offer the developing countries enough flexibility to pursue different growth strategies and to adopt needed complementary policies?

## RESPONSES FROM PANELISTS

Dr. Hertel agreed that extending the analysis of trade reform to take account of gender and other household dynamics is important. It is also very challenging because of data constraints, but represents a very promising direction for further research. Regarding WTO debates over developing countries' "policy space," he noted that in the Doha Round, the least developed countries are not being asked to make any concessions at all, a fact that may limit their negotiating power to ask for anything in return. To increase their benefits from the Doha Round, the poorest countries should offer to reduce their bound tariff rates, which average six times higher than the rates they actually apply. Doing so would help them gain concessions from the rich countries with no impact on tariff revenues.

Dr. Masters noted that the kind of low-nutrition, high-fertility poverty trap that he had discussed was really a "woman trap;" many African women have seven to eight children in 12 pregnancies, which causes them to become severely anemic, and to die not long after the birth of their last child. Meanwhile, they receive little schooling and are unable to enter the workforce.

## QUESTIONS, ANSWERS, AND DISCUSSION

**Question:** Are there potential gains from negotiating concessions among the developing countries, especially between the least developed and the more advanced developing countries?

Dr. Hertel responded that of all the steps that could be taken under the Doha Development Agenda, his project found that the most poverty-friendly would be to reduce tariff barriers to South-South trade. In part this is because developing countries have the highest tariff rates, which reduce South-South trade far below its potential. Moreover, tariff reductions among developing countries do not lead to an erosion of preferences as with the rich countries. By mutually reducing tariffs, developing countries would gain better access to each other's markets, which include the fastest growing in the world.

**Question:** What advice would you give to an African government seeking to encourage the emergence of large-scale commercial farms?

Dr. Masters acknowledged that many governments assume that larger farms must be more productive, but the truth is just the reverse: because managing farm labor is difficult, the most productive farm is almost always one that can be operated by a single family. Adopting policies to promote farms larger than those that result from an equitable spread of the available land among the farm population not only hurts the poor, but is deeply inefficient as well.

[O]f all the steps that could be taken under the Doha Development Agenda . . . the most poverty-friendly would be to reduce tariff barriers to South-South trade.

**Question:** First, could the agricultural research capacity of the United States be applied to the problems of Africa? And second, is there an emerging role for the biotechnology industry to develop Africa-specific crops?

Dr. Masters responded that the U.S. agricultural research system has enormous potential to contribute to agricultural progress in Africa. In fact, it has already done so, though to a much lesser extent than in Asia in the 1960s and 1970s and in Latin America in the 1970s. Biotechnology is also potentially very important, enabling us to insert genes that confer resistance to pests and pathogens. However, Africa has few plant varieties into which such genes could be inserted; without modern varieties, biotechnology has little value.

**Question:** There is now a lot of creative thinking on how to push the private pharmaceutical sector to produce vaccines for poor people's diseases. Could the same approach be used for international agricultural research?

Dr. Masters said that it could, and work is currently underway on the details of a specific financing mechanism for this purpose. Full documentation is posted online at <http://www.agecon.purdue.edu/prizes>. He described the broader problem as one of creating a financing mechanism that responds to the needs of the

poor for improved crops, despite the limited political and market power they wield. The problem requires public investment in agricultural research on food crops for Africa. The abundance of food grain in the world as a whole has limited international attention to this problem, even as food grains become increasingly scarce in much of Africa.

**Question:** In Mozambique, unions and protected industries have used the “need for complementary policies” argument to lobby against trade liberalization, arguing that Mozambique’s poorer roads, schools, and other public infrastructure would put it at a disadvantage relative to South Africa. What advice would the panelists give on this issue?

Dr. Masters would not advise any country to wait until all the desirable complementary policies are in place, because by then protective lobbies may emerge to block liberalization. At the same time, he would not expect to see major benefits from liberalization before increased productivity gives countries something to trade.

Dr. Hertel cited evidence from his project’s case study on Mozambique that undercuts the argument for postponing trade reform, at least as it pertains to agriculture. Mozambican farmers are especially disconnected from the market, and so could not suffer adverse effects from freer trade. Their small marketed surpluses, along with the low density of population, reduce the perceived need to invest in transport. Reducing trade barriers would induce more farmers to enter the market, and create a more visible demand for public investment in roads. In addition, the prevalence of smuggling suggests that Mozambique could increase its tariff revenues by reducing its very high current tariff rates.

Dr. Grown argued that trade alone will not be sufficient to allow developing countries to undertake the many complementary policies they need. Foreign aid will also be critical. There is a strong case for increasing foreign aid to countries that are relatively well-governed and transparent, countries that can use aid effectively to invest in infrastructure and human capacity.

Regarding sequencing, Dr. Grown agreed that countries should liberalize, but said that they need the “policy space” to decide what, when, and how much to liberalize. She endorsed Dani Rodrik’s argument that all cases of successful development in the last fifty years were based on creative, unorthodox development policies, where countries chose to remove different restrictions at different times. Finally, developing countries must be particularly careful with the timing of financial market liberalization. Liberalizing financial markets too quickly and too early can lead to serious volatility, which can cause great harm to the poor.



## KEYNOTE ADDRESS

### The World Bank: An Essential Global Institution in Peril

Sebastian Mallaby, Columnist, *The Washington Post*

**Mr. Mallaby** expressed deep concern about what he described as nonchalance towards global aid and development institutions. Although some new multilateral institutions may be needed, countries should be working to safeguard and strengthen the effective institutions that already exist. Trade and globalization will only increase in the future and, on balance, this is good for global prosperity. However, there are also serious losers from globalization, and it is important to do more to cushion the impact on those losers. For this, good institutions like the World Bank are necessary.

Mr. Mallaby said that he was amazed at the complacency he perceived on both the right and left concerning the permanence of the World Bank. Part of the criticism results from the false impression that the Bank can be managed as if it were a private firm. In the private sector, however, companies must meet the needs of clients in order to make a profit, so the interests of shareholders and clients are largely united. In contrast, the World Bank's shareholders are governments who have foreign policy concerns, environmental concerns, and many other issues that sometimes conflict with the interests of the borrowing countries.

The World Bank also differs from the private sector in the difficulty of measuring performance. Poverty reduction occurs over a much longer time span than used to measure corporate performance, while attributing development success or failure to the performance of particular staff members is inherently difficult. Every new president of the World Bank has begun by promising management changes, but only incremental improvements have been achieved.

Trade and globalization will only increase in the future and, on balance, this is good for global prosperity.

Second, Mr. Mallaby was concerned that the World Bank's International Development Association (IDA, the soft loan window) and International Bank for Reconstruction and Development (IBRD, the commercial loan window) were slowly losing their effectiveness. He disagreed with some stakeholders who suggest that IDA should shift from providing loans to making grants to developing countries. He believes that such a step would force a decline in the volume of new IDA lending and thus undermine the World Bank's comparative advantage in relation to bilateral programs.

Turning to the IBRD, Mr. Mallaby noted that loan volumes are down one-third from the levels of the early 1990s. This is because middle-income countries are increasingly choosing to borrow from private markets instead of from the IBRD. That puts pressure on the budget, because the Bank largely finances itself with the profits from IBRD lending. If this trend continues, the quality of World

Bank projects could decline over time, and the Bank will become dependent on donor grants, like UNDP. This is a cause for concern, in part because the World Bank produces a lot of high-quality research, an important global public good. In addition, profits from the IBRD help fund IDA as well as debt relief for low-income economies.

For the reduction in IBRD lending, Mr. Mallaby primarily blamed certain “campaigning” nongovernmental organizations (NGOs), which he said have managed to derail major World Bank projects based on unfounded claims of environmental damage and other problems. More broadly, Mr. Mallaby said, IBRD lending faces criticism from both ends of the political spectrum. On the right, some argue that middle-income countries should be forced to rely on international markets for their borrowing needs; on the left, some NGOs seek to advance particular agendas, such as human rights and environmentalism, to the point of losing sight of the goal of poverty reduction. In response, the World Bank has been forced to adopt multiple and time-consuming environmental, political, and financial procedures required before a project can be implemented, which in turn have so raised the non-financial costs of borrowing from the IBRD that middle-income countries are increasingly turning to private markets. Mr. Mallaby described the World Bank as an important tool of “enlightened foreign policy” that must be preserved and strengthened.

### QUESTIONS, ANSWERS, AND DISCUSSION

**Question:** One participant questioned how countries can advocate debt relief and grants, while opposing the use of these same instruments by the World Bank. She also asked how to keep IBRD lending attractive to those middle-income countries who can borrow in the private market.

Mr. Mallaby responded by saying that donor countries should pursue IDA debt relief as in the past—by offering fresh money to make up for IDA’s loss of debt service. Regarding the IBRD, he urged opinion leaders to help the World Bank break out of its “encirclement” by NGOs, which have forced the Bank to adopt cumbersome policies that undermine its effectiveness.

**Comment:** One participant urged greater attention to the details of why the U.S. Government has moved to support grants. Some developing countries have been unable to make payments for debt service, which meanwhile significantly hinder their development efforts. Debt relief lifts this burden. The risks of excessive debt burdens should be avoided. Support for grants in the Bank’s allocation formulas strikes a balance between alleviating debt burdens and maintaining reflows for the Bank’s financial health. Foreign assistance can be a tool to help trade reduce poverty, and the World Bank is one of the global institutions that plays an important role in helping countries benefit from trade liberalization.

## SESSION III

### Contrasting Country Experiences

Chair: **William Krist**

Senior Policy Scholar, Woodrow Wilson International Center for Scholars

**Mr. Krist** noted that the earlier presentations provided solid evidence that trade liberalization promotes economic growth, and that there is a correlation between growth and the reduction of poverty. However, the presentations emphasized that the effects vary from country to country. The panels also highlighted the importance of adjustment policies to accompany trade liberalization. The following presentations would focus on specific country experiences.

**Theodore Antwi-Asare**

Professor, University of Ghana, Legon

**Mr. Antwi-Asare** noted that from the 1970s to the early 1980s, Ghana suffered serious economic decline, with negative GDP growth, large budget deficits, and high inflation. Reforms began in 1983; trade reforms in particular began in 1986 with import liberalization and tariff reductions. Financial reforms began in 1987. Finally, Ghana abolished import licensing in 1992.<sup>11</sup>

Mr. Antwi-Asare said that in general, globalization has benefited some economic sectors and actors, but it may also have worsened poverty and income distribution in certain parts of the country. Globalization has created new jobs, but mainly in the export sector, which is only weakly linked to the rest of the economy. A great deal of foreign direct investment (FDI) has gone into mining, but the employment impact has been low.

Growth has averaged four and a half percent since 1983, and has recently exceeded five percent per year, due to better agricultural production and improved economic management. Domestic savings have remained low at about eight percent of GDP. The head count poverty index declined generally in the 1990s. Trade has increased as a

percentage of GDP. The major exports, including gold, cocoa, and timber, account for about 85 percent of total exports, a composition that has not changed significantly since the 1960s. Earnings from nontraditional exports, such as pineapples and flowers, have increased considerably in the last fifteen years.

Public sector employment declined because of public sector reforms and privatization measures. Formal private sector employment rose slightly between 1991 and

[T]rade reforms are important and have helped to open [Ghana's] economy. However, additional measures must be implemented to attract FDI, improve infrastructure, improve port handling, improve the unresponsive public sector, provide more efficient utility services, and focus on food crop farmers.

1998, and then fell by 8.7 percent of the economically active population in 2000. As Ghana's economy became more open, formal sector employment declined.

Ghana experienced a slight initial increase in poverty as the economy became more open, but as the economic reforms continued, poverty declined. The head count poverty index declined from 51.7 percent in 1992 to 39.5 percent in 1999, but these figures were not uniform across the country. Export crop farmers experienced a strong reduction in the head count poverty index, which fell from 64 percent to 39 percent during the 1990s. Poverty among food crop farmers, who make up a much larger share of the population, was initially higher and fell the least during the 1990s, from 68 percent to 59 percent.

In summary, Mr. Antwi-Asare said, trade reforms are important and have helped to open the economy. However, additional measures must be implemented to attract FDI, improve infrastructure, improve port handling, improve the unresponsive public sector, provide more efficient utility services, and focus on food crop farmers. Though faster economic growth has helped certain sectors, these complementary measures must be implemented more vigorously.

#### Debapriya Bhattacharya

Executive Director, Centre for Policy Dialogue, Bangladesh, and visiting Fulbright fellow, Center for Global Development

Bangladesh epitomizes the success story of trade liberalization and export-oriented growth and its impact on poverty. At the same time, Bangladesh also demonstrates the limits of relying on trade liberalization and export-driven growth to reduce poverty.

**Mr. Bhattacharya** began by stating that most empirical studies have failed to establish a relationship between an expanding volume of trade and poverty alleviation. However, studies have shown that most countries with rapid poverty alleviation did have high economic growth. He cited a recent World

Bank study that had established that during the 1990s, countries with rapid economic growth and trade liberalization achieved absolute poverty alleviation, but also tended to experience increased relative poverty [inequality].<sup>12</sup> From this he drew two conclusions:

- Even if trade liberalization does promote enhanced economic growth, complementary policies are still needed to sustain growth; and
- Even if growth alleviates poverty in some respects, it may still increase inequality.

Bangladesh epitomizes the success story of trade liberalization and export-oriented growth and its impact on poverty. At the same time, Bangladesh also demonstrates the limits of relying on trade liberalization and export-driven growth to reduce poverty.

Bangladesh undertook trade reforms in connection with IMF and World Bank structural adjustment lending, beginning in the late 1980s and continuing through the 1990s; as a result, Bangladesh implemented the “standard recipe” of the Washington Consensus. Trade liberalization was at the core of the structural adjustments: import quotas were eliminated, while average tariffs were reduced from 300 percent to 32 percent in a decade. Bangladesh also privatized and liberalized its financial sector. As a result, Bangladesh now exports goods and services worth more than \$7 billion per year, a four-fold increase in export volume since the early 1990s. Bangladesh has also experienced increased employment in the manufacturing sector (including an additional two million women employed each year), a one-percent increase in its average rate of GDP growth, and a decline in the incidence of poverty of one percentage point annually.

However, over the same period, Bangladesh has experienced increased inequality in both urban and rural areas, for several reasons. The rapid growth in the supply of female labor from rural areas has dampened wages in industry. At the same time, rural-urban migrants, especially women, face difficulties relocating to urban areas. In addition, there has been an “insider-outsider” problem where workers who already have industrial jobs try to limit hiring of new workers, so many job seekers are forced into the informal sector. The gap between skilled and unskilled wages has grown because of the relative abundance of unskilled labor and the time required to build new skills. The relative returns to agriculture have declined, leaving the large share of the population in rural areas relatively untouched by export-related growth.

A number of pro-active reforms have helped to support the growth of exports, including the elimination of tariffs on inputs used to produce exports; financial innovations such as self-liquidating letters of credit; and heavy investment in infrastructure in export processing zones. Meanwhile, Bangladesh has benefited from textile quotas under the Multi-Fiber Arrangement, which brought in substantial foreign direct investment, and subsequently, from preferential access to the European market under the Everything But Arms initiative.

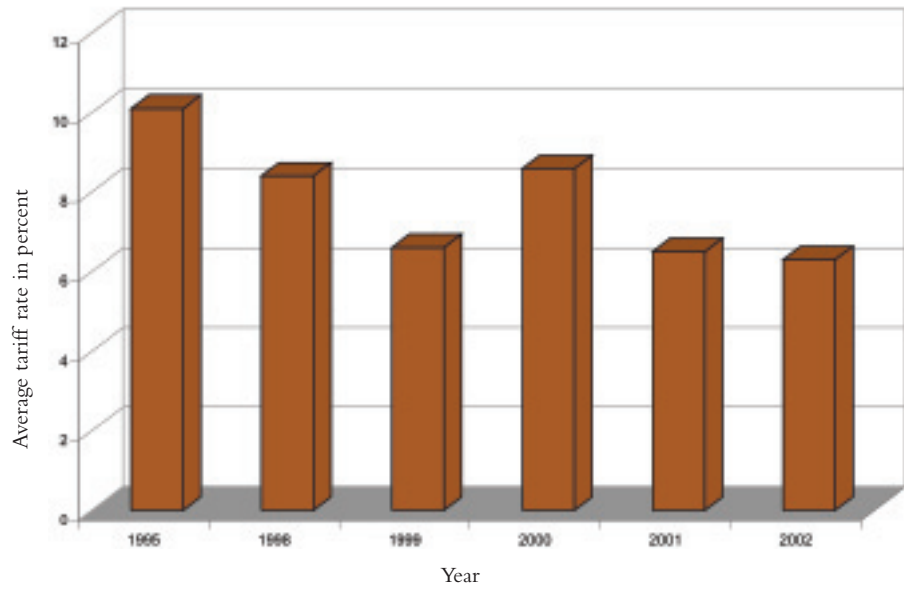
On balance, Mr. Bhattacharya said that the growth of exports and GDP per capita had been too slow to overcome the sheer volume of poverty in Bangladesh. For trade liberalization to succeed, it must be complemented by other policies, particularly in the financial sector and in trade facilitation. Meanwhile, there must be effective market access for poor countries. In this regard, he noted that Bangladesh’s access to the U.S. market remains less than that of countries participating in the Caribbean Basin Initiative or AGOA.

Rebeca Grynspan

Director, U.N. Economic Commission for Latin America and the Caribbean

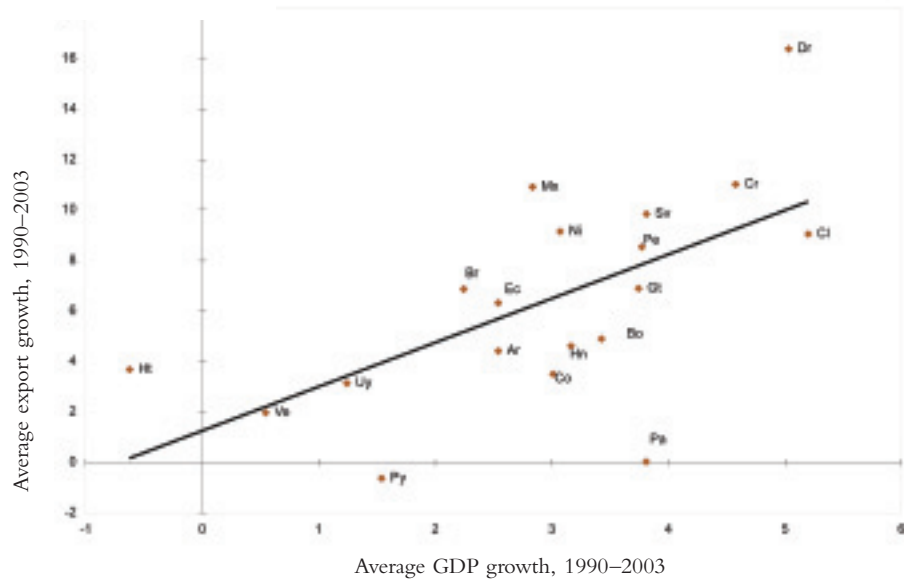
**Ms. Grynspan** emphasized that Latin America has undertaken vigorous reforms since the debt crisis of the early 1980s, a point often ignored by those who advo-

**FIGURE 6** Fall of Import Tariffs in Central America



Courtesy of Rebeca Grynspan, U.N. Economic Commission for Latin America and the Caribbean.

**FIGURE 7** Growth in GDP and exports, LAC 1990–2003



Source: Courtesy of Rebeca Grynspan, U.N. Economic Commission for Latin America and the Caribbean. Based on national data.

cate moving to a second level of reforms. Average tariffs have been cut from 29 percent to ten percent; taking trade agreements into account, they average five percent. Openness has increased dramatically in both South and Central America and in Mexico (Figure 6). Most of the trade liberalization and most of the export growth achieved has taken place within trade agreements, both with the United States and other regional groupings.

The liberalization process created great expectations, but the results have been less than expected, in large part because too little attention was paid to the region's specific conditions. In particular, the reform process largely ignored the region's high degree of inequality, which creates pockets of severe poverty, even in countries with relatively high incomes. The social protection system was allowed to deteriorate, forcing both the poor and middle classes to bear the brunt of adjustment costs.

As a result, exports and FDI grew at unprecedented rates, and income growth resumed beginning in the 1990s; income growth has been strongly associated with export growth (Figure 7). As a result, the incidence of poverty has declined in the region as a whole since 1990, but at different rates in different countries. However, the rate of growth achieved has been quite mediocre, averaging three percent per year rather than the five to six percent experienced during the import substitution era prior to the crisis.

In addition, the volatility of both income and consumption has remained very high, which is especially problematic because of weakened social safety nets. As a result, Ms. Grynspan said, when incomes fall both poverty and inequality rise, whereas poverty declines only slowly during periods of recovery, and inequality remains high.

Increased inequality has weakened the growth elasticity of poverty reduction—links among exports, growth, employment, and poverty reduction. As a result of this high and increased inequality, the region now has to grow faster to achieve the same rate of progress in reducing poverty, and to create jobs for the growing labor force. Ms. Grynspan noted that the actual gains from reform have turned out to be quite modest. As a result, growth has been too slow to prevent poverty from rising: the absolute number of people living in poverty rose from 135 million in the 1980s, to 200 million in the 1990s, to 222 million in 2004.

These results have had a strong impact on the public policy debate. People blame governments for what they see as weak outcomes from painful reforms, making it much more difficult for governments to gain public support for further reforms. The policy debate has become polarized, with sharp reactions against anything that can be portrayed as the “Washington Consensus.”

On the trade front, trade agreements will continue to be pursued, causing the value of existing bilateral agreements with the United States to erode as more

Initial conditions of infrastructure and education will be key in determining the degree to which countries benefit from trade liberalization.

countries are included. However, trade still offers potential dynamic gains, which are probably more important than the static gains resulting from changes in border prices.

In summarizing the policy choices for Latin America, Ms. Grynspan emphasized the need for solutions that are tailored to specific country conditions. Initial conditions of infrastructure and education will be key in determining the degree to which countries benefit from trade liberalization. In thinking about such policies in these and other areas, “complementary measures” is actually a misnomer: these measures should be seen as a development agenda, of which trade is an important part. In light of the mixed results from reforms that were often pressed upon countries before being fully evaluated, policymakers should be more humble when they offer policy advice to countries in the future.

Rosario Guzman

Executive Director, IBON Foundation, Philippines

**Ms. Guzman** reviewed economic and social data from the Philippines to support the argument that trade liberalization has contributed directly to the “production of poverty.” She described poverty as a symptom of underlying structural problems which have existed in the Philippines for at least four centuries, problems that trade liberalization has made worse.

For example, the unemployment rate in the Philippines has risen to 13 percent, the highest in Asia. Ms. Guzman attributed this trend to the destruction of local industry caused by opening the economy to foreign goods and capital; as a

result, domestic manufacturing has increasingly lost its capacity to create jobs. She pointed to government statistics showing that eight small and medium-sized enterprises close down every day, leading to the loss of 274 jobs; she attributed this trend to the impact of economic liberalization. The Philippine government blames the situation on a mismatch between the skills created by

The Philippine government blames [business failures and growing unemployment] on a mismatch between the skills created by the school system and those needed by the market; as a result, the educational system is being refocused to provide the English language skills needed to compete with call centers in India.

the school system and those needed by the market; as a result, the educational system is being refocused to provide the English language skills needed to compete with call centers in India. Meanwhile, she said, the agricultural sector has suffered a rising number of bankruptcies in response to trade liberalization under the WTO agreement on agriculture.

Ms. Guzman said that the bleak outlook for domestic employment is responsible for the Philippines having the highest rate of labor emigration in Asia; 12 percent of the population currently lives abroad. She said that workers emigrate not in search of better-paying jobs, but to find any jobs at all.



Ms. Guzman noted that one of the main benefits claimed for trade liberalization is that greater competition will lead to lower prices for consumers. However, this has not occurred in the Philippines; instead, local monopolies have caused prices to rise. The local economy is bankrupt, she said, and traders are taking advantage of the situation. Consumer prices for basic commodities have risen, even as farm-gate prices have been depressed.

Along with trade liberalization, the Philippines has undertaken a privatization program that Ms. Guzman characterized as especially aggressive; both the national power corporation and water supply system have been privatized. The privatization program has also turned out to be especially messy: after raising power and water rates dramatically, the private buyers have successfully lobbied for government bailouts.

Turning to poverty trends, Ms. Guzman said that the Philippines has set its national poverty line lower than the international one dollar-a-day line, in an effort to make the poverty statistics look better than they really are. The IBON Foundation has developed its own poverty measure, the Decent Living Standard. The organization estimates that 80 percent of the Philippine population falls below this standard. She attributed part of the problem to the government's efforts to hold down wages in order to attract FDI. As a result, there has been no legislated increase in wages in recent years, which she said aggravated the problems of poverty, unemployment, and rising prices. Other sources of data reinforce the argument that poverty is worsening in the Philippines. For example, the country's ranking in the U.N. Development Program's Human Development Index has fallen, while the Asian Development Bank estimates increasing poverty incidence in the Philippines.

Finally, Ms. Guzman said that trade liberalization has led to revenue losses that prevent the government from making any of the social investments needed to address the poverty problem. She noted that the Philippines suffers chronic budget deficits, but said that trade liberalization has made the situation worse. Meanwhile, rising budgetary allocations for debt service over the past five years have crowded out social spending. Nevertheless, the Philippines continues to finance a large share of its budget deficit through foreign borrowing, a pattern the IBON Foundation fears is steering the country toward a debt crisis similar to that suffered by Argentina.

#### Dr. Aseema Sinha

Assistant Professor, University of Wisconsin-Madison, and  
Fellow, Woodrow Wilson International Center for Scholars

**Dr. Sinha** raised four larger questions and discussed some of the empirical questions that emerged from the case studies.

- What are the important mechanisms that link trade with poverty reduction?  
If economic growth is the key, how can we ensure that the benefits are not

highly differentiated within the disparate groups of the poor?

- Complementary policies, particularly in infrastructure and education, are needed to stabilize the losers and encourage the winners. What are the institutional and political economic conditions needed to implement those policies?
- Why do we find so much variation in the impact of trade liberalization on poverty? How do initial conditions and sequencing affect growth?
- What kind of research needs to be undertaken to address the questions raised by these panels? Country studies should be complemented by comparative studies on similar and diverse developing countries.

## QUESTIONS, ANSWERS, AND DISCUSSION

**Question:** How would the panelists respond to the assertions of Ghanaian senior civil servants that they are not responsible for economic outcomes because (1) the government has designated the private sector as the engine of growth, and (2) they lack sufficient resources?

Mr. Antwi-Asare first noted that corruption is serious within the public sector and limits its effectiveness. He agreed that the private sector is the engine of growth, but emphasized that an effective public sector is still needed to facilitate the private sector's activities. The issue of inadequate resources is a real one, which the government of Ghana is currently addressing. Meanwhile, to address inequality, the government has introduced some targeted initiatives to improve the rural economy, including policies that encourage the production of textiles, oil palm, and cassava.

Referring to the links between trade and poverty, Mr. Bhattacharya noted that even where trade liberalization has helped reduce poverty, it has not been sufficient to overcome rampant poverty in most cases. In addition, trade liberalization leads to a loss of employment in inefficient import-substituting industries as well as growing employment in export industries; the net impact on employment depends on which effect is larger. He argued that most of the industries that have emerged in response to trade liberalization have relied heavily on imported inputs, a pattern that has limited their linkages to the domestic economy and their contribution to employment growth.

Another major issue is the need to build an effective partnership between the state and the private sector, within a transparent and accountable regulatory framework. Without such a regulatory framework, we will continue to see collusion between the state and established private sector interests against the interests of the poor. Finally, Mr. Bhattacharya emphasized the need to address situations of high and rising inequality, which reduce the contribution of faster growth achieved through policy reform to the ultimate goal of poverty alleviation.

## SESSION IV

### Challenges for Policymakers

Chair: **John W. Sewell**

Senior Scholar, Woodrow Wilson International Center for Scholars

**Mr. Sewell** noted the widespread consensus on the importance of an open economy. However, ensuring that the benefits of an open and liberalized economy fully reach the world's poorest people remains a significant challenge. The conference had made clear that in the context of trade liberalization, “complementary measures” are, in essence, development, suggesting an important role for development agencies and NGOs.

**Ruth Jacoby**

Director-General for Development Cooperation  
Ministry for Foreign Affairs, Sweden

**Ms. Jacoby** noted that everyone—developing countries, donors, and multilateral organizations—is looking for ways to ensure that developing countries reap the benefits of increased trade and trade liberalization, and to ensure that trade reform reduces poverty. On this matter, “we are all on a learning curve.” Speaking on behalf of the Swedish government, Ms.

Jacoby identified some key themes and priorities for trade and development.

Free trade is important, and should be conducted within an open, rules-based, and fair trading system. While trade liberalization has the potential to increase economic growth and thereby reduce poverty, this process is not automatic—complementary measures are essential.

Access to markets for products of particular interest to developing countries is

very important. Because agriculture is the backbone of most economies in the developing world, market access for agricultural and fisheries products is key to progress in the Doha Development Agenda.

Situations are country-specific and initial conditions, including inequality, affect the outcomes of trade liberalization. Most importantly, results depend on a country's institutional and social structures. If those remain static, trade liberalization will only intensify the problems and benefits of the existing structures. Good governance is therefore critical to ensuring that trade liberalization will contribute to poverty reduction. A fair, open, rules-based trade system will only work in an

While trade liberalization has the potential to increase economic growth and thereby reduce poverty, this process is not automatic—complementary measures are essential . . . Good governance is . . . critical to ensuring that trade liberalization will contribute to reduction. A fair, open, rules-based trade system will only work in an environment of relatively good governance . . . .

environment of relatively good governance in its broadest sense—one with effective institutions and respect for the rule of law.

Donor and recipient countries should both ensure coherence among their policies, including trade, but also in the areas of aid, foreign policy and security, education, and finance. Donor agencies should not be wasting money by using aid to ameliorate the negative impacts of their own governments' policies in other areas. For their part, developing countries should include trade policies in their development strategies, through the Poverty Reduction Strategy Paper (PRSP) process.

Finally, Ms. Jacoby emphasized that Sweden strongly supports trade-related technical assistance and aid. Like other development aid, such technical assistance must be sensible and well-harmonized. For this reason, Sweden believes strongly in coordinated multilateral efforts.

Dr. Gawain Kripke

Senior Policy Advisor, Oxfam America

**Dr. Kripke** said that Oxfam recognizes the potential value of trade, and is asking developing countries to make reforms. However, the organization also notes that reforms from developed countries will be equally important. Oxfam believes that the opportunities and risks of trade must both be acknowledged,

and policy measures must be put in place to address them.

Relatively modest gains in trade for developing countries can produce very large transfers of resources. If developing countries could increase their global export share by one percent, they could generate more revenue than all the foreign aid they receive.

Relatively modest gains in trade for developing countries can produce very large transfers of resources. If developing countries could increase their global export share by one percent, they could generate more revenue than all

the foreign aid they receive. However, many developing countries' trade is shrinking, not growing. Between 1990 and 2001 sub-Saharan Africa's share of world trade fell from just over three percent to roughly two and a half percent.

The pressure for trade reforms comes from many sources. For instance, both the International Monetary Fund (IMF) and World Bank have recommended that developing countries make trade liberalization part of their agreements. Meanwhile, the United States is asking developing countries to make trade reforms both in trade negotiations and in connection with its aid programs. Dr. Kripke thought that most of these are legitimate requests for reforms, but that implementing them places new burdens on developing countries. In some cases, adequate resources are not provided to help countries enact these reforms. He cited the Trade-Related Intellectual Property (TRIPS) agreement as a case in point.

Dr. Kripke pointed to a number of steps that the United States could take unilaterally, which he believes would help developing countries take advantage of opportunities that arise from trade, including:

- Providing preferential access for the least developed countries. Europe, Canada, and other rich countries have developed programs to provide such advantages to all least-developed countries.
- Revising its tariff system so that products from developing countries do not face higher tariffs than those from the developed countries.
- Eliminating tariff escalation, which imposes higher tariffs on finished products and encourages countries to export raw materials rather than goods with greater value added.
- Reducing subsidies to create more opportunities for developing countries.

Dr. Kripke also urged greater recognition of the risks of trade liberalization. He noted, for example, that food security risks among least developed countries, which he said are rapidly growing more dependent on food imports, threaten developing countries' ability to maintain adequate food supplies in the event of macroeconomic shocks, internal disruptions, or declining terms of trade.

Dr. Kripke said that agricultural trade offers both great opportunities and risks. In particular, he believed that U.S. agricultural production and export subsidies, especially for cotton, hurt the poor in importing countries. He suggested that some level of protectionism by developing countries may be appropriate, and that liberalization should be gradual and rationally sequenced. When developing countries liberalize their economies, they lose tariff revenue, which they find difficult to replace because their tax regimes are poorly developed. Dr. Kripke said that the depreciation of the dollar is of great concern for developing countries, since many of their exported commodities are valued in dollars. He urged the development of measures to help countries deal with currency fluctuations.

[T]he appreciation of the dollar is of great concern for developing countries, since many of their exported commodities are valued in dollars. [Dr. Kripke] urged the development of measures to help countries deal with currency fluctuations.

Dr. Kripke expressed frustration at the political energy expended on free trade agreements involving both the United States and Europe. He believes these agreements offer few benefits for the participating countries and called for a greater focus on multilateral initiatives like the Doha Development Agenda.

#### Dr. Kamal Malhotra

Senior Advisor on Inclusive Globalization, U.N. Development Program

**Dr. Malhotra** emphasized that trade policy and trade liberalization are two distinct concepts. Too often, in the current discourse the two are conflated.

Contrary to conventional wisdom, he said, the cross-national empirical evidence from the 1990s does not establish any clear correlation between trade liberalization—most often involving a reduction in import tariff rates—and eco-

conomic growth. For example, countries like China, India, Thailand, and Vietnam all impose high tariffs on imports, but have achieved rapid economic growth. Conversely, many of the countries that have liberalized their economies the most have not grown. This is not an argument for increased protection or higher tariffs; but it is certainly not a ringing endorsement for trade liberalization as the path to economic growth, let alone poverty reduction.

The empirical evidence, both current and historical, shows that if left to themselves, countries tend to reduce tariffs as they become richer. Dr. Malhotra said

[O]ne should not artificially separate [trade liberalization and complementary] policies. From a development point of view . . . there is a two-way relationship between human development and trade. The higher the level of human development, the more likely a country is to benefit from trade.

that trade liberalization and global economic integration are more often *outcomes* of growth sustained over time, rather than prerequisites for it.

Vietnam has recently been integrating rapidly with the global economy, but its growth rate has exceeded six percent for close to two decades. Many of China's trade reforms took place roughly ten years after China had attained rea-

sonably high levels of economic growth. The same was true of India, whose growth rate was faster during the high-tariff period of the 1980s than during the low-tariff period of the 1970s.

Before that, the East Asian "tigers" achieved rapid economic and export growth while applying different development strategies. For example, Korea emphasized export promotion and selective import substitution; Korea only liberalized imports in the 1980s, long after its initial period of rapid growth. Dr. Malhotra felt that the direction of causality needs to be looked at much more critically: it could be that economies do not need openness to grow, but rather that after economies grow, they open.

What are the implications for policy and for trade negotiations? Dr. Malhotra said that the evidence cited should make policymakers question the very high priority given to trade liberalization, at least during the early reform period. One would argue that trade liberalization, defined as reductions in import tariff rates and in non-tariff import barriers, may not be the highest priority from a development point of view in the early reform period. Nor is it a panacea for growth or poverty reduction, as it could have the opposite impact if carried out too rapidly and too early in the reform period.

If everyone agrees that trade liberalization cannot succeed without complementary policies, then one should not artificially separate these two sets of policies. From a development point of view, noted Dr. Malhotra, there is a two-way relationship between human development and trade. The higher the level of human development, the more likely a country is to benefit from trade. Many types of investments in human development must precede trade liberalization if real benefits are to be derived.

Dr. Malhotra urged listeners to look at the recent growth experience of China, India, and Vietnam, which undertook a lot of unorthodox institutional innovation. These were not Washington Consensus, second-generation types of institutional reforms. He concluded that countries need policy space to experiment with different types of policies and institutional designs.

What are the implications for the Doha Round in the WTO? Clearly on market access issues in both agriculture and industry, rich countries should rapidly reduce tariffs. Many have had decades, if not centuries, of protection. On the other hand, for poor countries, there must be asymmetry in the pace and the nature of the liberalization process. Many poor countries do not have any ability to provide subsidies. Tariffs are their only instruments; if countries reduce their tariff rates rapidly, they will face significant problems such as threats to small farmer livelihoods and food security. Countries will also be unable to offer strategic protection for emerging industries, which Mr. Malhotra said is important to help them build dynamic competitive advantages.

Dr. Malhotra criticized the linkage currently being made between reductions in agricultural subsidies and tariffs in developed countries in exchange for rapid reductions in industrial tariffs in developing countries. In his view, this approach risks totally eliminating the ability of developing countries to build up strategic industrial diversification through selective infant industry protection.

During the discussion period, an audience member noted that both China and India had very large internal markets, which called into question the relevance of their experience to the broader range of developing countries, which tend to be much smaller. He also stressed that Korea's import substitution efforts were not always successful. Dr. Malhotra accepted these points to a certain degree, but said that China, India, and Vietnam demonstrated the value of unorthodox policies, export promotion, and a relatively strong state. He argued that import substitution should not be applied across the board, but should instead be strategic, selective, and time-bound. This approach would be more difficult to follow today because of WTO rules.

Another audience member noted that Latin America has already lowered tariffs and so cannot make many further concessions. What are the options for the region? Dr. Malhotra suggested that there might be a case for the WTO to allow certain countries to raise tariffs again in certain areas. Some already have zero-percent tariffs, which they enacted unilaterally as part of their participation in the structural adjustment loan process. This option, he said, might work for Latin America.

Peter Grant

Director of Europe, Trade, and International Financial Institutions, U.K.  
Department for International Development (DFID)

There is a huge need to mainstream trade policies with poverty reduction strategies and other work in developing countries.

**Mr. Grant** stated that there is substantial room for donors to be involved both in traditional forms of support and in injecting development issues into trade policies and negotiations. There are still not enough development voices in key trade negotiations. To help remedy this, DFID set up its own trade department in 1997 to interface with other government agencies, and is actively working to ensure that ministries within the British government mainstream development into their agenda on trade issues.

Mr. Grant said that there is a huge need to mainstream trade policies with poverty reduction strategies and other work in developing countries. Trade offers substantial potential benefits in terms of economic growth and poverty reduction; South-South trade in particular offers great promise. But it is essential to recognize that trade liberalization creates losers as well as winners; detailed sector analysis is essential to designing good complementary policies.

DFID sees 2005 as a key year for the WTO negotiations, and is looking for an ambitious and strongly pro-development outcome in the Doha Development Agenda, with substantial progress at Hong Kong. DFID priorities include rules of origin, market access, agricultural subsidies, and greater flexibility in trade policy for developing countries. DFID is also strongly promoting new thinking on trade adjustment. Specifically for Africa, DFID sees challenges in infrastructure, simplifying tariff and customs systems, and improving regional integration.

Although the case for agricultural reform in the European Union (EU) is very strong, the impact of that reform is extremely complex. On one end of the spectrum there are Caribbean producers who are already losing money, even at current prices. African producers are moderately cost-competitive. At the other end of the spectrum, Mr. Grant expressed concern that Brazil could corner the market if access is completely open. In that context, DFID seeks to highlight

DFID is carrying out research on the impacts of agricultural liberalization and lobbying within the EU for adequate transitional assistance for countries that lose trade preferences as a result of EU agricultural reform.

development issues in a debate often dominated by agriculture ministries. DFID is carrying out research on the impacts of agricultural liberalization and lobbying within the EU for adequate transitional assistance for countries that lose trade preferences as a

result of EU agricultural reform. DFID is also seeking to support countries that are integrating sugar reform into their national development strategies.

DFID's priorities within trade-related foreign assistance are:

- Technical assistance and analysis;
- Investment in infrastructure; and
- Additional resources to offset adjustment costs.



In subsequent discussion, Mr. Grant expressed concern that bilateral agreements could undermine incentives for multilateral agreements; he also cited DFID's position that trade liberalization should not be subject to donor conditionality.

### Walter North

Senior Deputy Assistant Administrator, Bureau for Asia and the Near East  
U.S. Agency for International Development (USAID)

**Mr. North** began by discussing what USAID is doing to try to enhance the capacity of its partners throughout the developing world to become more effective advocates of their own interests in trade negotiations. USAID believes that, while there is a lot of conflicting information and contention about the advantages of an open trade regime, people do see and want to be part of a growing, global economy. Therefore, they need to be at the table with a voice that helps them articulate their interests in a compelling way and encourage other people to listen to their concerns, without doing so at the expense of the robustness of the international trading regime. This is complicated because it depends on so many variables. Ownership has to start with the countries themselves. USAID believes that open societies, where people are allowed to speak freely, rigorous analysis is undertaken, economies are open, and education is widely available, will be those best able to take advantage of an increasingly open and globalizing economy.

USAID believes that open societies, where people are allowed to speak freely, rigorous analysis is undertaken, economies are open, and education is widely available, will be those best able to take advantage of an open and globalizing economy.

Mr. North noted that USAID has been collaborating with its British colleagues on the G-8 agenda. Britain is pushing for a dramatic increase in assistance flows, especially in Africa. However, Mr. North emphasized that the impact of aid depends critically on local ownership and capacity to use aid effectively. Poverty reduction needs to be part of national strategies and trade policies must be a part of the overall development discussion. Mr. North acknowledged that there will be winners and losers in the transition to a more open economy. Donors need to be responsive in order to avoid retarding long-term growth prospects. For example, the ACP (African, Caribbean, and Pacific countries) program on sugar has led to the EU spending hundreds of millions of dollars and has produced trade-distorting outcomes.

Mr. North noted that one of the areas that USAID is focusing on is trade capacity building (TCB). This includes working with national governments to deepen their understanding of the costs and benefits of trade liberalization, improve their access to information, and stimulate research that will help localize and inform their understanding of domestic impacts. Additionally, USAID is examining social safety nets and how to put in place targeted assistance that does not further distort the economy.

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**Caren Grown** is the Director of the Poverty Reduction and Economic Governance team at the International Center for Research on Women, where she leads research on asset accumulation and women’s property rights and the impact of multilateral and national economic policies on gender equality. From 1992 to 2001, Grown was a senior program officer at the John D. and Catherine T. MacArthur Foundation in Chicago, where she managed research networks on a wide range of economic issues.

**Rebeca Grynspan** is the Director of the United Nations Economic Commission for Latin America and the Caribbean. She is the former Vice-President of Costa Rica and has held a variety of senior positions in the Costa Rican government. Grynspan previously served as Coordinator of the Social Sector, promoting the government’s Plan Against Poverty and managing the government’s economic and social sectors.

**Rosario Guzman** has been the Executive Director of the IBON Foundation since 2000. She was previously Deputy Executive Director of the IBON Foundation and Head of the IBON Databank and Research Center. Guzman has written several IBON research outputs and co-authored various books, including *Globalizing Philippine Mining* with Antonia Tujan, Jr.

**Ann Harrison** is Professor of Agricultural and Resource Economics at the University of California, Berkeley. She is also a Research Associate at the National Bureau of Economic Research. Her research focuses on the impact of trade reforms and foreign investment in both developing and developed countries. Her publications have appeared in economic journals, including *American Economic Review*, *Journal of Labor Economics*, *Journal of Development Economics*, and *Journal of International Economics*.

**Thomas Hertel** is a Professor of Agricultural Economics at Purdue University and a Visiting Scholar at the World Bank Group. He conducts research in the analysis of trade policies. He is also Executive Director and founder of the Global Trade Analysis Project (GTAP). Hertel has published numerous journal articles and edited *Global Trade Analysis: Modeling and Applications*.

**Kent Hughes** is Director of the Program on Science, Technology, America and the Global Economy at the Woodrow Wilson Center. He is the author of *Building the Next American Century: The Past and Future of American Competitiveness* (2005). Hughes previously served as the Associate Deputy Secretary at the U.S. Department of Commerce, where he worked to define and implement a long-term competitiveness strategy. Before joining the Clinton Administration, Hughes served as President of the Council on Competitiveness.

**Ruth Jacoby** is the Director-General for Development Cooperation in the Swedish Ministry of Foreign Affairs. She has held multiple senior positions dealing with trade and development since joining the Ministry of Foreign Affairs in 1970. She has served as Executive Director to the World Bank Group for a constituency of countries including Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway, and Sweden.

**Gawain Kripke** is the Senior Policy Advisor on international trade policy at Oxfam America. He has diverse experience as an advocate, media spokesperson, and author. Kripke heads the policy work of Oxfam America's Make Trade Fair campaign that aims to change the rules of international trade so that trade becomes a powerful force for reducing poverty across the globe.

**William Krist** is a Senior Policy Scholar with the Woodrow Wilson Center's Environmental Change and Security Project, where he is working on trade and sustainable development. His current focus is on the Doha Trade Round, and what outcome is needed to ensure that it truly promotes sustainable development. Krist has also completed several consulting projects on sustainable development, including projects for the U.S. Agency for International Development (USAID) and the Environmental Protection Agency. Before joining the Woodrow Wilson Center, Krist was Senior Vice President for International Trade with the American Electronics Association.

**Kamal Malhotra** has been with United Nations Development Program since August 1999 and is the Senior Adviser on Inclusive Globalization. He heads the Bureau of Development Policy's trade policy work and team, and has overall responsibility for UNDP's policy work on the global dimensions of debt, capital flows, and development finance. Malhotra is currently leading a UNDP Trade and Sustainable Human Development project and was the lead author of *Making Global Trade Work for People*.

**Sebastian Mallaby** is a *Washington Post* Columnist and a member of the paper's editorial board. His interests cover a wide variety of domestic and international issues, including globalization, international development, and U.S. economic policy. He was a 2004 Pulitzer Prize finalist for his editorials on Darfur. Mallaby spent 2003 as a Senior Fellow at the Council on Foreign Relations, where he wrote a history of the World Bank under James Wolfensohn entitled *The World's Banker*, which became a *Washington Post* bestseller. Mallaby joined the *Washington Post* in 1999 after thirteen years with *The Economist*.

**William Masters** is Professor of Agricultural Economics at Purdue University researching food and agricultural policy, technology, and market institutions. He is currently on the Advisory Committee of the Partnership to Cut Hunger in Africa, and is Scientific Adviser to the International Foundation for Science in Stockholm, Sweden.

**Neil McCulloch** is Senior Poverty Economist with the World Bank Group, Indonesia. He has extensive experience in the analysis of poverty, and is currently analyzing poverty in Pakistan and China. He has experience working in Africa as a macroeconomist with particular expertise in the area of fiscal and trade policy reform. McCulloch was a fellow at the Institute of Development Studies at the University of Sussex and was the Budgetary Adviser for the United Kingdom Overseas Development Administration.

**Walter North** is the Senior Deputy Assistant Administrator for Asia and the Near East Bureau of the U.S. Agency for International Development (USAID). Prior to this, he served as Mission Director for India from 2000 to 2004 and for Zambia before that.

**Borany Penh** is a political economist on the Poverty Analysis and Social Safety Nets team of the Office of Poverty Reduction at the U.S. Agency for International Development (USAID). She is responsible for advising the Agency on the institutional, political, and economic factors that affect poverty, particularly in conflict and fragile states.

**John W. Sewell** is a Senior Scholar at the Woodrow Wilson Center in Washington, D.C. He is the former President of the Overseas Development Council (ODC). His current research project is based on the premise that the United States now confronts an emerging "globalization agenda" of new and old problems. Sewell's interests focus on how globalization has affected the relationships between the old industrial countries, emerging economic powers in Asia and Latin America, and the poorer countries that risk marginalization.

**Aseema Sinha** is Assistant Professor at the University of Wisconsin-Madison, where she teaches in the areas of comparative politics, political economy, social

movements, globalization, and South Asia. She is currently a Woodrow Wilson Center Fellow in Washington, D.C., at work on the project, “Negotiating Global Trade Regimes: Private Interests, Public Purpose, and Global Linkages in India” focusing on the impact of globalization on India’s politics and political economy. Her principal research deals with the linkages between politics, economics, globalization, business-government relations, and comparative federalism in South Asia.

**Bruce Stokes** is the International Economics Columnist for *The National Journal* and a Journalism Fellow at the German Marshall Fund. In addition, he is a Fellow with the Pew Research Center, where he works on the Global Attitudes Project, a survey of changing public values and attitudes toward globalization, modernization, democratization, and current foreign policy concerns. Stokes is also a regular commentator for the program *Marketplace* on National Public Radio.

## APPENDIX I

### Agenda: The Impact of Trade Liberalization on Poverty

Friday, April 15, 2005

8:30a.m. – 6:00p.m.

**Woodrow Wilson International Center for Scholars**

**One Woodrow Wilson Plaza**

**1300 Pennsylvania Avenue, NW**

**Washington, DC 20004**

Most economists argue that increasing international trade contributes to economic growth and therefore to the alleviation of poverty. Beyond basic questions and theoretical costs and benefits, however, the relationship between trade and poverty becomes considerably more complicated. Even in the most successful cases, the impact of increased trade depends heavily on the condition of existing institutions, public investments in education and infrastructure, the presence of safety nets, and the impact of the world economy. This daylong conference will bring together national and international stakeholders, including economists, policy analysts, policymakers, and business leaders from different parts of the developing world to examine how development and trade liberalization affects poverty.

#### SESSION I: THE BASIC LINKS BETWEEN TRADE, GROWTH, AND POVERTY

**8:45a.m. – 10:15a.m.**

This session will review current research on the links between trade, growth, and poverty. The panel will provide different perspectives on these questions and will include voices from both emerging market and least developed countries. This session will briefly assess what current research can and cannot tell us about the impact of trade on poverty.

**Chair:** **Kent Hughes**, Director, Program on Science, Technology, America and the Global Economy, Woodrow Wilson International Center for Scholars

**Speakers:** **Neil McCulloch**, Senior Poverty Economist, World Bank, Indonesia

**Ann Harrison**, Professor of Agricultural and Resource Economics, University of California, Berkeley

**Commentator:** **Bruce Stokes**, Trade and International Economics Correspondent, *The National Journal*

## SESSION II: HOW THE POOR RESPOND TO OPPORTUNITY AND ADVERSITY

**10:30a.m.–12:15p.m.**

This panel will set the stage for discussion in Sessions III and IV by exploring how poor households respond to trade-related opportunities and challenges such as drops in prices or increases in competition. What conditions affect the poor's ability to take advantage of opportunities created by trade liberalization such as increased exports or a shift from subsistence to marketable crops? Because the poor are not a homogeneous population, the panel will explore how the impact of trade, coping strategies, and needed policies will vary from one group of poor to another.

**Chair:** **Borany Penh**, Political Economist, Poverty Analysis and Social Safety Net Team, U.S. Agency for International Development

**Panelists:** **Thomas Hertel**, Professor, Purdue University and Visiting Scholar, World Bank

**William Masters**, Professor of Agricultural Economics, Purdue University

**Commentator:** **Caren Grown**, Poverty Reduction and Economic Governance Team, International Center for Research on Women

## LUNCHEON

**12:30p.m.–2:00p.m.**

### **The World Bank: An Essential Global Institution in Peril**

**Keynote Speaker:** **Sebastian Mallaby**, Editorial Writer and Columnist, *The Washington Post*

## SESSION III: THE CONTRASTING COUNTRY EXPERIENCES

**2:15p.m.–3:45p.m.**

Panel members will use country studies to understand how complementary investments (education, roads, health, etc.) and policies (effective administration, competitive exchange rates) have influenced the impact of trade liberalization on poverty in Africa, Asia, Latin America and elsewhere.

**Chair:** **William Krist**, Senior Policy Scholar, Woodrow Wilson International Center for Scholars



**Panelists:** **Theodore Antwi-Asare**, Professor, University of Ghana at Legon

**Debapriya Bhattacharya**, Executive Director, Centre for Policy Dialogue, Bangladesh, and Visiting Fulbright Fellow, Center for Global Development

**Rebeca Grynspan**, Director, United Nations Economic Commission for Latin America and the Caribbean

**Rosario Guzman**, Executive Director, IBON Foundation, Philippines

**Commentator:** **Aseema Sinha**, Assistant Professor, University of Wisconsin-Madison and Fellow, Woodrow Wilson International Center for Scholars

#### SESSION IV: CHALLENGES FOR POLICYMAKERS

**4:00p.m. – 5:30p.m.**

Policymakers in USAID, international financial institutions, and national legislators must apply the lessons drawn from models, statistical analysis, and case studies to current trade negotiations. If, for instance, the Doha Round opened up markets in specific commodities (say cotton, rice, or sugar) how might specific countries respond? What complementary policies, say investments in port facilities or sanitary inspections, would make a difference? How important are improved health and education? Could investments in better roads, the development of an agricultural extension service, and risk limited micro-finance open opportunities for small farmers?

**Chair:** **John W. Sewell**, Senior Scholar, Woodrow Wilson International Center for Scholars

**Panelists:** **Ruth Jacoby**, Director-General for Development Cooperation, Ministry for Foreign Affairs, Sweden

**Gawain Kripke**, Senior Policy Advisor, Oxfam America

**Kamal Malhotra**, Senior Advisor on Inclusive Globalisation, United Nations Development Program

**Walter North**, Senior Deputy Assistant Administrator, Bureau for Asia and the Near East, U.S. Agency for International Development

## APPENDIX II

### Will CAFTA Help Central America's Poor?

**Bruce Strokes, *National Journal***

Over the next few weeks, Congress may finally begin a great debate about the Bush Administration's Central American Free Trade Agreement, a deal to extend tariff-free access to the U.S. market for five Central American nations plus the Dominican Republic. Ways and Means Committee chairman Bill Thomas, R-Calif., wants to bring CAFTA to a vote in the House of Representatives before Memorial Day. Senate Finance Chairman Grassley, R-Iowa, has said he thinks a Senate vote can be held sometime in the next few months,

In the days and weeks ahead, much Congressional discussion will focus on the impact sugar imports from Central America may have on the incomes of U.S. cane and beet sugar farmers. There will be graphic floor speeches about the plight of U.S. textile and apparel workers who may lose their jobs thanks to imports from Central America. And, behind the scenes, the White House will carefully weigh the impact of a CAFTA victory or defeat on President Bush's waning public approval rating.

As might be expected, the CAFTA debate on Capitol Hill will focus on the agreement's impact on Americans. Little time will be spent assessing the impact of the deal on farmers and workers in Central America. A small group of development experts and members of Congress think this would be a mistake.

"There needs to be more concern for the impact of CAFTA on the poor in Central America," said Rep. Sander Levin, D-Mich., at a recent meeting of the Council on Foreign Relations. "They have to share in the benefits of trade", he added, because "addressing income inequality [in the region] is central to the development of democracy in these countries."

The Bush Administration, the GOP majority in Congress and its business allies argue that trade liberalization stimulates growth and that this tide will lift all boats, including those of the Central American poor. But that argument is based on economic theories that, soon-to-be published research suggests, are "not consistent with reality".

For their part, Democrats, including Levin, have largely focused their CAFTA efforts on improving protections for labor rights, arguing this will empower workers to defend their own standard of living. But a third of Central Americans work in agriculture and many others labor in the informal sector, largely beyond the reach of the law. Strengthening labor laws may be necessary, but it's not sufficient for the poor.

"More trade does not necessarily mean less poverty" concludes a new study, *Strengthening the Connection Between Trade and Development by Reorienting Trade Capacity Building Assistance*, by Interaction, a Washington-based coalition of development and humanitarian groups. "One of the key premises for drawing developing countries into the global trading system and urging them to liberalize their trade policies is that

this should promote growth and poverty reduction.” What is needed, the coalition argues, are “trade capacity building programs geared to promoting the growth of trade-related economic activities that benefit the bottom tiers of developing country economies—the poor, with a focus on women who make up the vast majority of the poor in many countries.”

So far, this fundamental issue—the impact of trade on incomes in Central America and how to alleviate the inevitable adverse consequences of trade liberalization on the defenseless poor—has largely been ignored by Congress.

“Free markets and open trade are the best weapons against poverty,” said President George W. Bush, in 2002 in explaining his intention to pursue a free trade agreement with the countries of Central America.

The President’s faith in trade is based on trade economists’ beliefs that the poor and the unskilled in developing countries are most likely to gain from trade liberalization because they produce the sugar, shoes and apparel that rich countries, such as the United States, want to import. But, observed Ann Harrison, a professor of agricultural and resource economics at the University of California, Berkeley, and editor of the forthcoming book *Globalization and Poverty*, at a recent conference at the Woodrow Wilson International Center for Scholars, “this Washington consensus ‘to just open up’ is just plain wrong.”

One reason is that labor in developing countries is not nearly as mobile as trade theorists assume. For example, in Central America, for trade to benefit unskilled workers—such as farm laborers—they need to be able to move out of jobs that will face greater competition from U.S. products that become more available thanks to CAFTA—such as corn—and they need to move into jobs in exporting industries that are likely to be selling more to the American market—such as apparel. But that mobility is not a given. In both India and Colombia, trade liberalization has increased poverty among workers in some industries or locales precisely because labor has proven immobile.

Similarly, economists have long argued that when trade barriers fall unskilled labor in a developing country will benefit more than skilled labor in that same society, because in a more open market there will be a greater foreign demand for the goods produced by unskilled workers. But in Colombia, trade reform has been associated with rising inequality, as skilled workers have captured most of the benefits of globalization. Today, there is greater income equality in most Central American economies than in Columbia. The challenge, say some development economists, is to avoid CAFTA making the rich richer and the poor poorer in Central America.

And finally, economic theory holds that when two countries trade, each has a comparative advantage in making and exporting some things, while importing others. But in a global economy, such neat divisions of labor can get more complicated. Even though Mexico has ample unskilled workers to produce goods for the U.S. market, China has even cheaper labor. So, today, many Mexican-based industries are pulling up shop and moving to China to supply the U.S. market from there. Central America may find itself hard pressed to realize many of the advertised benefits of

CAFTA thanks to that same 800 pound Chinese gorilla in its rear view mirror. In fact, in March of this year, two dozen manufacturers left Guatemala alone to relocate in Asia, according to Guatemala's ambassador to the United States José Guillermo Castillo.

That doesn't mean that trade cannot benefit the poor in some circumstances, as CAFTA supporters contend and a number of the country-level studies in Harrison's book substantiate.

In the mid-1990s in Panama, trade liberalization led to a fall in unemployment. In Zambia, poor consumers have gained from trade liberalization because the goods they buy have gotten cheaper, while poor producers in exporting sectors of the economy have benefited from higher prices for their goods. And, as Neil McCulloch, a senior poverty economist with the World Bank Group in Indonesia, reminded the audience at the Woodrow Wilson center, "there is no empirical support for the proposition that trade liberalization has an *adverse* impact on the poor."

But, said Harrison, "trying to say there are no losers [from trade liberalization] is patently absurd." Since the North American Free Trade Agreement took effect in the mid 1990s, 1.3 million Mexican jobs have been lost and most Mexicans have lower real wages, according to a 2003 Carnegie Endowment for International Peace study. Not encouraging news for Central America.

Moreover, opening markets clearly helps some and hurts others, according to the Harrison book. In Colombia, individuals working in the sectors of the economy facing increased competition from imports have gotten poorer. Those producing for the export market have grown richer. In Mexico, where NAFTA led to falling corn prices thanks to a flood of corn from the United States, really poor farmers with less than 5 hectares of land, who are net consumers of corn because their farms are too small to produce enough for their own use, have benefited. Rich farmers, those with more than 15 hectares, have come out ahead. Those in the middle have suffered.

Such outcomes from trade liberalization lead Harrison to conclude that "targeted compensation for losers is terribly important". If poor Mexican corn farmers had not received income support from their government, their real incomes would have been halved during the 1990s.

But there is little provision for the poor in the CAFTA deal now before Congress.

The Bush Administration touts its doubling of funds for trade capacity building: money for infrastructure in Central America to boost production of tradable goods, funding of institutions and training to administer and promote trade, and aid for vulnerable sectors of Central American economies to help them find niche export markets. And, in fact, spending by the U.S. Agency for International development on such programs in the 5 Central American countries and the Dominican Republic has grown from \$24.6 million in 2002 to \$53.2 million in 2004, thanks in large part to the efforts of Rep. Jim Kolbe, R-Ariz.

But most of this money is aimed at improving Central America's competitiveness: \$17.1 million for export promotion and training and \$16 million to help expand agricultural exports in 2004. Such funds are certainly useful in preparing Central

America for the rigors of global competition, but they are hardly Harrison's "targeted compensation for losers".

Moreover, poverty reduction is not even a primary purpose of the effort. As the Interaction paper notes, "In USAID's definition of [trade capacity building], poverty reduction is mentioned in passing." It doesn't have to be this way, the development coalition asserts. For example, in the United Kingdom, spending on trade capacity building is required to "help countries work up a development plan or poverty reduction strategy that incorporates trade and growth."

USAID's efforts are not alone, however. In 2003, the Inter-American Development Bank approved \$319 million in financing for Central American projects designed to help improve competitiveness and raise productivity. Nearly a third of that money went to El Salvador, where, for example, much of it is to be used to help privatize state-run maritime and air transport facilities. More efficient ports and airports may be necessary to enable El Salvador to take better advantage of access to the U.S. market, but such investments will, at best, have only an indirect impact on poverty.

As Vincent McElhinny noted in a CAFTA critique distributed by Interaction last year, what is notably absent from the Bush administration's CAFTA package are "non-reimbursable funds for Central America in accordance with the expected adjustment needs of the region." In many ways, he notes, the administration's efforts are devoid of the ambition demonstrated by the European Union, which is spending billions of dollars to raise the living standards of the poor in Poland, Latvia and other nations that have recently become part of the European single market.

For their part, CAFTA's Democratic opponents want Central American countries to strengthen their labor laws and they want the deal to include trade sanctions to insure that governments in the region enforce such rules. "Strengthening unions would allow workers to bargain over wages, severance and other working conditions," said Kimberly Ann Elliott, co-author of the Institute for International Economics book *Can Labor Standards Improve Under Globalization*. This could clearly help poor workers improve their lot, she said, if done right.

But, warned the World Bank's McCulloch, maximizing the impact of trade liberalization on employment and wages and mitigating the adverse consequences also requires flexible labor markets. In Indonesia, for example, the minimum wage is six times the poverty income, a level that has become a disincentive to hire new workers, or at least an incentive to hire them off the books, where they are denied other benefits and protections and can not be taxed.

While most economists agree on the need for labor market flexibility, what businesses see as flexibility, laborers see as a license to exploit. More research is needed, said Harrison, to identify whether labor legislation protects only the rights of the small fraction of workers who already labor in the formal sector of the economy or whether better legislation and its enforcement softens short-term adjustment costs and could help the labor force in Nicaragua or El Salvador share in the gains from greater access to the U.S. market.

Moreover, argues economist Howard Rosen in a paper on labor market adjustment in developing countries being prepared for the World Bank, “governments should aim to replace the ‘stick’ of employment laws, which make it difficult to terminate workers, with the ‘carrot’ of incentives to firms to retain workers.”

But in the case where layoffs are unavoidable, workers in Central America will be out of luck. Not one of the CAFTA countries has an unemployment insurance program to provide a safety net for those who are likely to lose their jobs thanks to trade liberalization. “The International Labor Office, the World Bank and other international institutions should provide technical assistance to help countries design and implement their own unemployment insurance system,” Rosen recommends.

To train workers for the new jobs trade liberalization is supposed to create, writes Rosen, “governments should offset the costs of training dislocated workers, either through direct government expenditures and/or through contributions from former employers.”

All this will require money, far more than is now available from USAID. Rosen suggests the International Monetary Fund will have to get into the game, to help countries address their new financial burdens.

There is greater consensus among development economists about the importance of services and subsidies for the rural poor who are likely to be most adversely affected by CAFTA. In both China and India, agricultural extension services have helped reduce rural poverty as have income support payments in Mexico. With even a larger percentage of their populations living in rural areas, this will be a tall challenge for Central American economies.

And the Mexican experience offers a cautionary lesson. Thanks to local politics, Mexican payments to farmers were based on acreage, which had the perverse effect of increasing production at a time of falling prices, worsening that problem. The lesson: poverty must be attacked, but it must be done smartly.

To date, said McCulloch, “this debate [about the impact of trade on poverty] is very much based on assertion and anecdote.” And more of the same can be expected on Capitol Hill over the next few weeks.

What is clear from new research, however, is that CAFTA is not the win-win proposition its proponents allege. Trade liberalization creates both winners and losers. And, even within the same country, CAFTA may lead to income losses for some rural agricultural producers and some urban workers, while other consumers and producers in the same country gain. With such differentiated outcomes, the plight of the poor can not simply be assumed to improve as import barriers fall. Without a safety net, training and job placement efforts for those dislocated by trade, many Central Americans may rue the day CAFTA passes the U.S. Congress.

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## APPENDIX III

### More Than Free Trade

Sebastian Mallaby, *The Washington Post*

Five years ago free-traders had a lazy time: Anti-globalization protesters were crude, their arguments easily deflated. Today a harder debate is underway. Troubling questions about trade are being raised by globalization's defenders. The risk is that politicians will seize hold of those questions and provide the wrong answers.

The first question is whether some poor countries lose from trade liberalization, a possibility illustrated by the end of global quotas on textiles and apparel at the start of this year. In the 1980s and early 1990s, developing countries pressed for these quotas to be lifted, hoping to boost exports to rich countries. But in the 15 years between their demanding this reform and getting it, the emergence of China as a trading superpower has altered the picture. Many poor countries would have been better off keeping their quotas, meager as they were, rather than venturing into a quota-free world in which China corners the market.

This phenomenon isn't true only for textiles. Lots of poor countries enjoy protected access to rich markets, extended via special bilateral and regional trade deals; global trade liberalization would erode the value of those preferences. If the United States abolished its sugar quotas, for example, efficient producers such as Brazil, Thailand and Colombia would gain market share. But inefficient producers, some of which actually import sugar in order to reexport it to the United States because of the quota-induced price gap, would be cut out of the market.

What's true for quotas is also true for subsidies. Ending rich countries' agricultural subsidies would reduce farm output in the United States and Europe, and less output would boost global prices. That would be great for developing countries that export food, such as Brazil and Argentina. But as Arvind Panagariya of Columbia University points out, nearly all of the world's poorest countries are net importers of food. Higher global prices might actually hurt them.

The second troubling question concerns the impact of free trade within poor countries. Even if a country as a whole benefits, the poorest groups or regions in that country may not. For example, suppose that rich countries abolish farm subsidies and quotas, so that global food prices rise. This will benefit farmers in developing countries who produce more food than they need to feed themselves—their surplus produce will bring in more revenue. But it will harm farmers who grow too little to feed themselves and who do non-farm work to earn wages and top up their diet. Most African farmers fall into this second category.

Rich-country politicians, who already bend over backward to please domestic protectionist interests, will no doubt seize on these questions to justify further obduracy. But this is exactly the wrong reaction. For one thing, the gains from trade outweigh the losses; for another, today's losers may become tomorrow's win-

ners, given time to adapt to liberalization. Moreover, the conundrums that I've described don't show why trade is bad. They show why it has to be backed up with complementary policies.

Some of these policies are comfortable extensions of the free-trade philosophy. A formidable team of economists directed by Berkeley's Ann Harrison is about to come out with a volume titled *Globalization and Poverty*; a central message is that free trade works best for countries with labor mobility. For example, India's dramatic trade liberalization in the 1990s produced equally dramatic strides against poverty. But because Indian workers move surprisingly little between industries and regions, people in sectors that contracted as a result of the lifting of tariffs were trapped. Liberals who seek to soften trade deals by writing mobility-restricting labor regulations into them need to rethink their strategy.

But the other policy necessary to complement free trade may force new thinking on some parts of the right, because it comes down to more development assistance. Rather than maintain farm subsidies that punish Argentine and Brazilian exporters, for example, rich countries should get rid of the subsidies—and then cushion the blow to food-importing countries by increasing aid to them. If just half of the \$350 billion currently spent on farm subsidies were converted into development aid, official foreign assistance would triple. By spending a chunk of that money on agricultural research targeted at Africa, a woefully neglected field, rich countries could score a triple win—for African farmers, for Brazilians and Argentines, and for their own taxpayers.

Equally, aid offers the best way out of the trade-preferences dilemma. It's tempting to rig the rules so that China doesn't corner the market in textiles: Central America is nearer to home, Africa is especially poor, the Middle East has terrorism. But rewarding friends with trade preferences can be self-defeating in the end. Pretty soon so many regions get special access that nobody is really special. Moreover, preference deals generate onerous red tape: African-made clothing gets duty-free access to the United States, but to qualify it has to show that its constituent parts were not made in China and then assembled in Africa, and arguments as to what constitutes a constituent part can employ battalions of lawyers. It's far better, in other words, to grant everybody access free of red tape, and then to give some regions a helping hand with carefully designed aid programs.

Five years ago, large chunks of political opinion believed that trade was bad for poor countries; thankfully, that delusion has receded. But today, we must guard against the opposite mistake. Trade, though good, is not a panacea.

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