

The effect of trade and related policies on country economic performance has been debated for more than a century. The literature generated by that debate, especially since the 1960s, concludes that although trade offers long-term benefits for developing countries, trade liberalization alone is not sufficient for economic growth. Rather, it has become clear that maximizing trade and welfare outcomes depends on the underlying macroeconomic environment, industrial policies for export development, the design and sequencing of trade policies, external constraints and opportunities, and complementary policies. These factors in the outcome of trade liberalization and a summary of current debates are the subject of this appendix. The objective is to provide the context for the Bank's approach to trade. The first half of the appendix draws on Oyejide (2004).

Trade Policy Reform and Economic Growth: Implications for Bank Advice

Belief that international trade is critical for economic growth underpinned the Bank's policy advice to its client countries from the early 1980s—there were few alternatives, as import substitution had run its course. The first multi-country studies of developing countries' trade regimes (Little, Scott, and Scitovsky 1970 and Balassa and Associates 1971 and an influential study done by the NBER and summarized in Bhagwati 1978 and Krueger 1978) had systematically detailed the inefficiencies of the import-substituting development strategies that prevailed throughout the developing world. The studies were influential in promoting export orientation as a path to more rapid economic growth.¹

Despite differences of opinion among economists on the causal relationship between

trade reform and economic growth, the long-term benefits of increased trade are unchallenged. Few countries have grown rapidly and reduced poverty by following a long-term autarkic approach. As noted in Panagariya (2004), neither Rodrik (1999) nor Stiglitz (2002), critics of the Bank's approach to trade liberalization, dispute the benefits countries can gain by opening up their economies. Researchers on both sides of the issue also increasingly agree on the importance of country specificity and of institutions in disentangling the various policies that affect trade and growth.

Macroeconomic Environment and Trade Policy Reform

Three macroeconomic factors contribute to maximizing the success of trade reform: macroeconomic stability, the real exchange rate, and the timing of foreign exchange market liberalization and trade reform.

Macroeconomic stability

There is a strong consensus in the literature regarding the necessity of macroeconomic stability for trade liberalization to have significant effects on resource allocation within an economy. In Papageorgiou and others (1991), smaller budget deficits kept inflation low and thus supported a real depreciation of the domestic currency during trade policy reform. The study showed that poor macroeconomic policies were more commonly associated with reversals in trade liberalization than any other factor. Nominal currency devaluation must often be combined with anti-inflationary monetary and fiscal policies, as well as appropriate aid management policies, to ensure that it is converted to real depreciation and not subsequently reversed.

The literature is less clear on whether trade policy reform should be implemented after macroeconomic stability has been achieved or whether liberalization and macroeconomic adjustment should proceed simultaneously (Dean, Desai, and Riedel 1994). Some analysts maintain that stabilization should precede liberalization (Rodrik 1992, p. 88); some go so far as to say that stabilization may be all that matters; while others insist that an outward-orientation already implies commitment to maintaining macroeconomic stability (Bhagwati and Srinivasan 2001, pp. 3, 11).²

The real exchange rate

There is also a strong consensus on the relevance of the real exchange rate for export promotion. Williamson (1997, p. 17) asserts that “perhaps the most important single instrument in implementing outward orientation is exchange rate policy.” Considerable empirical evidence exists on the relationship between export performance and the real exchange rate. Studies such as those of Diaz-Alejandro (1984), Paredes (1988), and Caballero and Corbo (1989) show that real exchange rate misalignment can be detrimental to export growth, and that real exchange rate variability and uncertainty are associated with negative effects on export performance in some Latin American countries. On the positive side, the literature also suggests that the exceptional export growth performance of East Asian countries and Chile is closely related to the ability of these countries to avoid real exchange rate overvaluation while minimizing exchange rate volatility.

Timing of trade policy and exchange rate reform

Debate continues on the role of exchange rate policy in trade liberalization and whether exchange rate changes need to precede or accompany trade reform. As pointed out by Krueger (1978) and Pritchett (1996), in countries where foreign exchange shortages due to overvalued exchange rates and extensive exchange controls are binding constraints on trade, the removal of import restrictions would be ineffective without reform of the foreign exchange market. In particular, trade liberalization without devaluation

may be rendered incompatible by the resulting adverse balance-of-payments effect. To resolve this incompatibility, a “trade-liberalizing devaluation” (Collier 1991) may be necessary; this would be designed to permit a relaxation of trade and payments restrictions without creating an adverse balance-of-payments effect. The possibility that trade liberalization without devaluation may create a short-run external balance problem suggests that the two policy initiatives are strongly complementary (Corden 1989; O’Connell 1997).

These considerations may explain the results of several studies of trade liberalization in developing countries during the 1980s and early 1990s. For instance, Papageorgiou and others (1991) report that most of the successful trade liberalization programs began with a depreciation of the real exchange rate. The results reported in Elbadawi and Soto (1997) for a sample of African and other developing countries “corroborate the view that without real depreciation, trade liberalization would be difficult to sustain.” The policy implications from these results is that, for countries with overvalued currencies, the first step in the adjustment process should be to bring about a sustained real devaluation, which would enable the real exchange rate to be then held stable before implementing any trade liberalization.

Policies for Export Development

Two other types of policy measures are important for export development: compensatory measures designed to offset any inherent anti-export bias in a trade regime³ and additional incentives meant to address specific problems of exports.

To develop exports, governments can compensate for the adverse effects of policies that penalize the export sector by designing measures that restore incentive neutrality between production for export and import substitution. The required neutrality of incentives can be achieved by allowing export producers to purchase their inputs and sell their outputs at competitive prices; that is, by granting exporters and their main suppliers duty-free access to inputs, and granting exporters the right to retain all their export proceeds. Several mechanisms exist for

granting duty-free access to exporters for imported inputs. These include duty drawback or rebate systems, and bonded manufacturing warehousing arrangements. In addition, geographically separated entities (export processing zones) may be set aside from which all import trade barriers are excluded.

Export development can also be promoted by applying additional incentives to tackle specific export problems. Falvey and Gemmell (1990) categorized those used in Asian countries into three groups: input-related incentives, output-related incentives, and incentives associated with externalities. Prominent in the first group are subsidies on public utility services, special depreciation allowances on capital inputs, and preferential credit arrangements. The second group includes tax exemptions, export credits, export subsidies, provision of infrastructure, and assistance with overseas export marketing. Government services in aid of export quality promotion are among the incentives in the third group.

The effectiveness of these incentives—and other industrial policy measures—continues to be debated (Pack 2000). But the literature notes some successes. In particular, it is generally agreed that export processing zones have been effective in Madagascar, Mauritius, and Mexico. In addition, Agosin (2002) suggests that temporary subsidies were a powerful tool for stimulating the growth of non-traditional exports in Chile.

Developing countries currently face greater constraints in using selective and industrial policies compared to the period when the East Asian “tigers” did. This is due to the changing economic environment and changes in the international “rules of the game.”

As noted by Lall (2004, p. 28), technical changes and the globalization of production complicate the use of industrial policies, compared to the past. He noted that rapid technical change “reduces the scope for, and raises the risks of some forms of industrial policy.” Isolation from fast-moving technologies may hold back the development of competitive capabilities and make targeting more difficult. Globalization also makes some past industrial policies less useful or more risky and costly. For example, excluding

foreign direct investment (FDI) is now less feasible as a means of boosting domestic technologies as few countries have the ability to match international innovation on their own. Similarly, few developing countries have domestic enterprises with the ability to mount export drives to match the integrated production networks of multinational companies. Finally, the ability to impose conditions on multinationals is also more limited as more countries compete for FDI.

Several of the export promotion measures described above have had their use constrained or prohibited by recent WTO agreements. For instance, the Agreement on Subsidies and Countervailing Measures (SCM) prohibits export subsidies by countries with per capita incomes above \$1,000. Similarly, the Agreement on Trade Related Investment Measures (TRIMs) mandates the removal of local content and trade balancing requirements from the export promotion and industrial policy arsenal of WTO members. These measures were used with some success in East Asia.⁴

Chang (2004) contends that while the changing international economic environment and new rules have imposed considerable extra constraints on the use of industrial policies, these constraints are not overwhelming. In particular, the least-developed countries can use exemptions and longer transition periods. He notes that the demands for a more development-friendly trade round may also offer additional flexibility for industrial policies in the future.

Design, Sequence, and Duration of Trade Policy Reform

Design issues related to trade policy reforms include: the components of the trade reform package, the sequence in which the various elements should be reformed, and how long it should take to complete trade reform.⁵

Design questions arise from the need to ensure that the elements of the reform package have effects that are mutually reinforcing. Questions about sequence arise for two reasons. First, trade policy reforms in developing countries can be complicated and difficult to manage; hence, they often strain implementation capac-

ity that may be eased by sequencing the various components. Second, sequencing is desirable to the extent that it permits the policy reform program to consider the varying adjustment needs of the different sectors of the economy as well as the interactions between different elements of the package (Winters 2000).

The literature is clear that import policy reform should begin with the elimination of quantitative restrictions. Where these are transformed first into tariffs the economy gains through the removal of distortions associated with rent-seeking and monopoly power, increased transparency of the trade regime, and increased tariff revenue (Dean, Desai, and Riedel 1994).

A similar sequence applies on the export side. The removal of export licensing and prohibitions typically occurs first, simultaneously with elimination of restrictions on imported inputs used in the production of exports. Next, export taxes (usually on agricultural exports) are removed and other export incentives (including direct and indirect subsidies) introduced. In practice, easing exporters' access to imported inputs at world prices has had a more significant impact on export growth than more general export incentives (Thomas and Nash 1991).

Whether trade policy reform should be strong and sudden or moderate and gradual remains in dispute. For instance, Bhagwati and Srinivasan (2001, p. 2) assert that "nothing requires that, faced with high trade barriers, a country's tariff reforms must be on a shock therapy path." The deliberate, systematic, and sequential implementation of trade policy reform also resonates with Collier, Greenaway, and Gunning (1997, p. 307) who note: "in the presence of multiple policy instruments and conflicting interest groups competing for attention, policy reforms are more likely to be incremental than comprehensive." In any case, there are circumstances in which adjustment costs associated with policy reforms may be lower if adjustment can be spread over time (Winters 2000), provided the delay does not become an excuse for aborting an otherwise necessary reform. On the other side, sometimes a "big bang" approach is viewed as necessary to take advantage of an opportunity for reform and to signal credibility and commitment of new leadership.

Empirical evidence on the speed of reform is not conclusive. Papageorgiou and others (1991) suggest that strong programs that start boldly tend to have a better chance of success and sustainability than weaker, more prolonged ones; they claim that a reform program that endures six years is very likely to last indefinitely. However, Lal (1995) suggests that the gradualist approach to trade reform, initiated by India and China in the early 1990s, may turn out to be both successful and sustainable.

External Constraints and Opportunities

Early World Bank support for trade policy reform in developing countries was predicated on the expectation that most gains from such reforms would accrue from each country's own liberalization efforts. Hence, the resulting reform programs emphasized unilateral rather than multilateral trade liberalization. Yet, much of the trade policy reform undertaken by the industrial countries up to the mid-1990s took place under the auspices of GATT.

The importance of multilateral negotiations for promoting trade liberalization in developing countries eventually was recognized and has been associated with a number of advantages, including that it enables countries to obtain external market access "concessions" through an exchange process, binding their reforms to an international framework as a means of resisting internal anti-reform interests, preventing reversals, and endowing their reforms with greater security, transparency, and credibility.

From the early 1990s, why and how external market constraints may cause problems for developing countries that adopt outward-oriented trade strategies has been increasingly recognized (Cline 1989 and Ghosh 1992). Industrial countries are the primary export markets of newly industrializing developing countries and market access barriers in those industrialized countries limit export opportunities of developing countries. One of the first manifestations of this concern was "export pessimism"—the belief that developing countries' exports could not successfully penetrate the economies of the developed countries (Hughes 1992). This was because industrial country imbalances at that time, com-

bined with unfavorable trends in international markets, would sharply limit the extent to which world markets could continue to absorb exports from developing countries. Ghosh (1992) argued that unless the industrial economies enjoyed faster growth, there would be little room for developing countries to adopt and successfully implement outward-oriented trade policy reform.

Some researchers agree that trade policy reforms in developing countries are likely to be more successful if they are supported by improved economic performance and more accommodating policy changes by the developed countries (World Bank 2002b). In particular, improved market access for poor countries in the developed countries may be necessary (Ianchovichina, Mattoo, and Olarreaga 2001).

Developed countries have made some efforts to provide developing countries with special market access. For example, the high-income countries have offered the generalized system of preferences as a means of mitigating the effects of high tariffs on developing countries' exports. These schemes have helped some developing countries to take advantage of export opportunities in preference-giving countries. But the schemes have not fully eliminated the trade barriers faced by low-income countries for several reasons. First, the schemes are unilateral and can be eliminated or modified at will by the preference-granting countries. Second, they have limited product coverage, and the preference mainly applies to products that already face relatively low tariffs. Third, the preferences are easily eroded by non-tariff measures such as safeguards, anti-dumping, rules of origin, and "graduation" mechanisms.

A more effective remedy suggested by some researchers is to extend duty-free and quota-free market access to all exports of the least-developed countries. This could achieve two important objectives: help mitigate the deficiencies of existing preferential market access schemes and significantly increase the export growth of this set of countries.⁶ But while agreeing that improved and predictable market access for African products could be helpful, at least to some extent, Helleiner (2002b) suggests that before market access, the poorest countries

must first be assisted to address their export supply capacity constraints through increased investment in infrastructure and skills.

Research suggests that developing countries should focus on both increasing their access to industrial country markets and reducing their own protection levels to reap the gains from liberalization in the context of multilateral trade negotiations (Anderson et al. 2002).⁷

Complementary and Mitigating Measures

Trade policy reforms generally are expected to work with lags that may vary by country, sector, and the periods over which the reforms are implemented. In principle, therefore, trade policy reforms tend to yield their full efficiency and welfare gains in the long term. But trade policy reforms also have costs that often are incurred well before the related stream of benefits can be realized. In addition, there is an inherent distributional problem: the "burden" of the reforms may not fall on the same agents who reap the benefits or the cost may not be shared in the same proportion as the benefits across different groups. Trade policy reform works by reallocating resources from less efficient to more efficient uses. This reallocation is not without costs. In particular, as workers are displaced from inefficient enterprises, some amount of transitional unemployment and output loss is likely.

Trade policy reform may be associated with a second type of problem. When import barriers are reduced, imports may increase sharply and rapidly, thus generating a balance-of-payments deterioration. For these and similar reasons, policymakers are often concerned that trade policy reform may have negative effects on the balance-of-payments, output, employment, as well as income distribution.

These concerns are unjustified in certain cases. Papageorgiou and others (1991) suggests that for many countries studied, the costs of trade policy reforms were very small, even in the short term. In most of these countries, the balance-of-payments position improved as a result of policy since the improvement in export performance was both quick enough and large enough to more than offset the surge in imports. Other studies (such as Oyejide, Ndulu, and Gunning

1999) show that short-term costs constitute realistic concerns for countries contemplating or implementing trade policy reforms. Furthermore, while cautioning against broad generalizations about the depth and duration of possible transition losses associated with trade policy reform, Winters (2000) suggests a few pointers. First, the more protected the sector being liberalized the greater the transitional costs are likely to be, although this sector may also offer the largest long-run returns to reform. Second, if the labor market is exposed to very large shocks emanating from policy reforms that render it dysfunctional, transitional unemployment may be larger in volume and longer in duration. Third, rapid or concentrated reforms are more likely to generate transitional losses through unemployment than more diffuse reforms.

Complementary, compensatory, and mitigatory measures are typically designed to address the costs associated with trade policy reform. In particular, complementary measures may be used to reduce the adjustment cost of reform and provide households the assistance that they may need to avoid poverty by enabling them to attain a greater degree of economic viability (Winters 2000). Thus, complementary policies may need to be put in place before or at the same time as a trade policy reform is implemented.

Compensatory and mitigatory policies include measures designed to protect in some way those who suffer losses as a result of trade policy reform. For these policies, targeting is critical because of the need to focus especially on those who lose rather than offer general support that could be costly and wasteful. For example, when trade policy reform leads to employment losses it should be possible to identify those affected and arrange redundancy payments and re-training programs. Sometimes the pattern of loss has a regional dimension and hence, mitigative measures may have to reflect this. In general, therefore, compensatory and mitigatory policies involve the creation of “safety nets” for those who suffer from the transitional costs of trade policy reform.

With respect to the sequencing of mitigatory measures, to the extent that they must be appropriately targeted, it is reasonable to assume

that they should be put in place after trade policy reform has been implemented and the transitional costs begin to show.

By comparison, opinion is divided regarding whether complementary policies should precede or be implemented simultaneously with trade policy reform. It has been suggested (for instance by Winters 2000) that if a trade policy reform program is credible and it includes significant transition periods, it could be an important stimulus for the complementary measures that are required. Hence, it may not be necessary for complementary measures to precede trade policy reform. However, this point of view may underestimate the extent of institution building and capacity creation required before a low-income country can effectively realize the full potential of a major trade policy reform.

The sequencing of complementary measures may not, in fact, be fully amenable to theoretical or even empirical generalizations. It may be necessary to evaluate the structure and performance of relevant market institutions as well as the economy’s supply response capacity constraints before designing a major trade policy reform program.

Trade and Growth

The role of trade and hence trade-related policies on country performance has been a subject of controversy for well over a century. The debate about whether trade was a handmaiden or an engine of growth was theory-based before becoming more empirical from the late 1960s onwards, when developing countries were first subjected to intensive scrutiny.

This rest of this Appendix traces the main “turning points” in the debate over trade and growth to help place the evaluation in context.⁸ The focus is on three main areas: the role of international trade in economic growth, the approaches to trade liberalization, and the links between trade, distribution, and poverty.

The Role of Trade in Economic Growth

The belief that international trade is critical to economic growth underpinned the World Bank’s policy advice to its client countries from the early 1980s. The Bank and its clients had few al-

ternatives as import substitution of non-durable consumer goods had run its course. Little, Scott, and Scitovsky (1970) Balassa and Associates (1971) were the first multi-country studies of trade regimes in developing countries, the former commissioned by the OECD Development Centre, and the latter by the World Bank. These were followed by an influential study carried out by the NBER and summarized in Bhagwati (1978) and Krueger (1978).

The multi-country studies, following a common methodology, were the first to detail systematically the inefficiencies of the then-prevalent import-substituting development strategies followed throughout the developing world. The studies were influential in promoting export orientation as a path to more rapid economic growth. The experience of the East Asian “tigers” that moved the furthest away from the purely import substitution model was simplified and generalized to support the export-led growth model.⁹

As pointed out by Little in his analytical appraisal of changes in the field of development economics, this vision of the role of trade in a country’s development strategy was a minority view in the profession. It was only with the advent of the two oil shocks and debt crisis that the failure of what Sachs and Warner (1995) called the “state-led” development strategy became apparent and more widely accepted in development thinking. World Bank researchers had contributed to the literature; but this thinking was not put into practice until lending conditions were used in structural adjustment lending, and was subsequently crystallized in the 1987 World Development Report (WDR), which focused on trade policies.

Despite the potential benefits from trade, policies related to trade liberalization remain controversial in some circles for at least three reasons. First, critics assert that it led to instances of too rapid liberalization, resulting in severe transitional costs of adjustment reflected in increased poverty, de-industrialization, and job loss. They also argue that the impact of trade reform on exports has been limited.¹⁰ While the long-term gains from trade appear to be well established, the benefits may be less visible in the short run for at least three reasons: (i) inappropriate macroeconomic policies, such as in-

complete stabilization resulting in contractionary fiscal or monetary policies that squeeze out credit from the private sector and reduce the entry of new firms or result in appreciation of the real exchange rate, thereby reducing competitiveness; (ii) missing complementary (so-called “behind the border”) policies and institutions to support faster export growth such as customs, rule of law, quality and standards, as well as trade logistics;¹¹ and (iii) insufficient or inadequate skills and capital to take advantage of emerging opportunities that arise from the liberalization. The dissatisfaction with the outcomes associated with more open economies culminated in large protests at the World Trade Organization’s 1999 meetings in Seattle.

The second reason trade is controversial is that, in contrast to the “first best” world that underpins standard trade theory, the “real” world has several deviations that are likely to influence the outcome of unilateral trade liberalization. The existence of protectionism in industrial and other developing countries, the rise of regionalism and unanticipated political events are just three factors that can result in unanticipated outcomes. Therefore, some critics of trade have denounced the Bank for not taking these factors into account.

The third reason is related to the politics of any reform, but especially trade. Changes in relative prices under trade are important and hence, anticipated distributional shifts lead to strong opposition and controversies that, at times, end in policy reversals.

Beyond these points on imperfect trade liberalizations, there are questions about the link between trade reform and economic growth. The econometric evidence on the links between trade reform, economic growth, and trade performance remains mixed.¹² It has proven difficult to use the cross-sectional approach to establish causality and identify the role of other intervening factors such as geography and institutional factors. In particular, the verdict is still out on the relative importance of each factor.

Researchers continue to extend existing methodologies to explore the links between trade reform and growth. Specifically, they have focused on refining the measurement of “open-

ness” and on incorporating additional economic variables that influence whether and the extent to which trade liberalization results in accelerated economic growth. In particular, by identifying the years when non-reversed trade liberalization programs were launched and using panel regression techniques, Wacziarg and Welch (2003) find that on average, growth, investment, and openness increase after trade liberalization. Others have focused on the role of additional country-specific factors, such as the role of institutions, in determining the success of trade reform (Rodrik, Subramanian, and Trebbi 2004; Freund 2003).

The new growth theory predicts that openness to trade (and investment) increases access to new technology, enhances efficiency by making market structures more competitive, allowing the exploitation of economies of scale and by spurring innovation. In a study of 93 countries, Edwards (1998) finds that total factor productivity growth is faster in more open economies. Subsequent work in this area has supported this finding.¹³ De Melo (2005) documents how the Bank’s research in this area has contributed to establishing the microeconomic channels at the firm and sector level through which trade openness contributes to economic growth. Building on firm and census surveys in manufacturing, Bank research contributed to establishing the beneficial impact of “import discipline” on pricing and productivity gains. More recently, De Melo notes that Bank industry studies have complemented firm-level studies by establishing the links among a variety of factors (R&D embodied in trade, foreign direct investment, and product variety) and productivity growth.

Despite differences of opinion among econometricians on the links between trade reform and economic growth, areas of common ground exist. While the econometric evidence on the causality between trade openness and economic growth is equivocal, few countries have grown rapidly and reduced poverty following a long-term autarkic approach. As noted in Panagariya (2004), neither Rodrik (1999) nor Stiglitz (2002) ultimately disputes the benefits from countries opening up their economies. Researchers on both sides of the issue also increasingly agree on the importance of country specificity and of in-

dividual country case studies in disentangling the various policies that affect trade and growth. Thus, if trade is necessary for sustained economic growth, countries that have followed largely different approaches to liberalization can have equally good performance (see for example the country examples in the Rodrik [2003] survey). Finally, while international trade is necessary for sustained economic growth, countries take different paths to liberalizing trade with no assurance that doing so will by itself necessarily lead to accelerated growth.

The Approaches to Trade Liberalization

The relative importance of the three primary routes to trade liberalization—multilateral, preferential regional trading arrangements, and unilateral—have varied and evolved. The institutional framework for global multilateral trade liberalization is the World Trade Organization (WTO), and before 1996, the General Agreement on Tariffs and Trade (GATT). The WTO enforces a rules-based system that governs trade relations among its members. The organization affects the trade policies of its members through a number of channels: periodic Trade Policy Reviews, multilateral trade negotiations, the dispute settlement mechanism, as well as the accession process into the organization. Bhagwati (1982), World Bank (World Bank 2002b), and others have argued that participation (and hence liberalization) through the multilateral route ultimately benefits the developing countries as it provides them with a stronger voice than they would have in bilateral negotiations. While the Uruguay Round (launched in 1986 and completed in 1993 under the GATT) was not the first round of liberalization undertaken under the multilateral framework;¹⁴ it was the first in which developing countries participated in large numbers.

Mixed views persist regarding the achievements of the Uruguay Round that preceded the current Doha Development Agenda. On the positive side, large tariff cuts were accomplished compared to previous rounds, “voluntary” export constraints were abolished, agriculture was brought under GATT discipline, a dispute settlement mechanism was codified through the establishment of the WTO, and an agreement was

reached on phasing out non-tariff barriers under the Multi-Fibre Arrangement (MFA).

Despite estimated aggregate gains, the impact on individual countries and regions was uneven. Even the elimination of the MFA, while advantageous for exporters in theory, was subsequently found to potentially adversely affect developing country exporters. More generally, developing countries signed the Single Undertaking, committing them to agreements in the Uruguay Round that they later found difficult to implement due to capacity constraints. In addition, many (including World Bank researchers) found the costs associated with implementing some of these new agreements were inconsequential.¹⁵ Trade-related capacity building that was promised under the Uruguay Round was slow to arrive, leading to a Uruguay Round “hangover”¹⁶ for developing countries and setting the stage for their greater caution in subsequent trade negotiations.

The most recent round of trade negotiations, the Doha Development Agenda (DDA), was initiated in November 2001. More than any previous round, the DDA aims to make multilateral trade liberalization more development-friendly. Estimates of the gains from the DDA range widely and depend greatly on the extent to which both developing and industrial countries open up their markets. As industrial countries have not agreed to significant agriculture liberalization, the actual gains from the DDA can be quite low.¹⁷

Since Doha, the DDA negotiations have limped along. Industrial countries thus far have not been able to offer the type of concessions that researchers deem necessary to make the Round beneficial to developing countries. Developing countries have been much more assertive than in previous rounds and (to some extent based on the experience with the Uruguay Round) are more skeptical of the touted benefits. Following a disappointing interim meeting in Cancun in September 2003, a framework on the modalities for negotiations was agreed in August 2004. Nonetheless, substantial risks persist in reaching agreement on the DDA given the stances of the negotiating parties.^{18, 19}

In the meantime, regional preferential trading arrangements²⁰ have sprung up in every re-

gion of the world. Over 300 such RTAs currently exist.²¹ Several factors underlie the proliferation of RTAs—strategic and geopolitical interests, uncertainties about the future of the multilateral trading system following the failure to launch a round in Seattle and subsequent difficulties in reaching agreements following the Doha meetings, and a desire to use the strength of numbers to develop larger markets and increase regional cooperation on a range of trade and non-trade issues. The Asia-Pacific Economic Cooperation (APEC) arrangement, the European Union, MERCOSUR, the North American Free Trade Agreement (NAFTA), and numerous other free trade areas and customs unions now co-exist (uncomfortably) with the multilateral system and its rules.

Two camps of thought exist on whether RTAs should be viewed as “building blocks” or “stumbling blocks” to liberalizing trade.²² Supporters of RTAs discount the extent to which trade diversion exceeds trade creation under RTAs and argue that in some circumstances smaller RTAs may be easier for countries to negotiate. Skeptics argue that RTAs are likely to result in a “hub and spoke” type of growth with the smaller spokes being disadvantaged. In the view of some researchers, these arrangements reduce global welfare and undermine the institutional architecture of the multilateral trading system.

Empirical evidence on the extent to which RTAs help liberalize and expand trade is less common and, similar to the theoretical literature, there is no clear consensus. In a recent review of regional trading arrangements in Africa which has more than 30 RTAs (or an average of four per country),²³ Yang and Gupta (2005) find that RTAs have been ineffective in expanding trade or investment. Limão (2005) shows empirically that U.S. preferential trading arrangements have harmed multilateral liberalization.

The primary route to trade liberalization for most Bank clients during the 1980s was unilateral trade liberalization. Much of this liberalization was carried out with the support of the Bank and the International Monetary Fund (IMF).

Not much research has been done on how much protection has been reduced through the different channels. Analyses done by the Bank in 1997 and again in 2004 suggest that a large share

of trade liberalization carried out by Bank clients occurred through the dialogue with the Bank and associated lending.²⁴ In a recent paper, Rose (2004) questions the extent to which the multi-lateral system has actually influenced levels of protection. By refining the econometric approach used in the gravity model to take into account different groups of countries and the asymmetric liberalization pattern, Subramanian and Wei (2003) find a positive and strong, albeit rather uneven, impact of the WTO on trade liberalization. In particular, their results suggest that the WTO has not contributed to greater openness in developing countries. But it may be more important to separate the rules-making aspect of the WTO from its ability to liberalize trade.

Trade, Income Distribution, and Poverty

With the establishment of the Millennium Development Goals (MDGs), reducing poverty and facets of poverty such as vulnerability and deprivation have been strengthened as development priorities. The extent to which economic growth reduces poverty depends on, among other factors, the pattern of growth, the extent to which it is broad-based, and the degree to which it is labor-absorbing. The discussion of the links between trade, distribution, and poverty is thus part of the larger discussion on the circumstances under which economic growth is “pro-poor.”

A major contribution to the analytical underpinnings of the links between trade liberalization and poverty is provided by McCulloch, Winters, and Cicera (2002). They identify the three main channels through which macro-level trade liberalization influences poverty at the household and individual level as enterprises, markets, and the state. Their analysis then examines how changes in border prices, tariffs, and other trade reforms work through each of these channels, recognizing that market imperfections, non-market factors, institutions, and gender can all influence the linkages between trade and poverty.

Empirical evidence on unambiguous links between trade and poverty is limited. Ben-David and Winters (2000) note that trade reform can result in losers in the short-run but argue that improving supporting policies such as safety nets and job retraining are ultimately more benefi-

cial in reducing the hardships of the poor rather than abandoning the reforms. Hertel and Reimer (2004) provide an up-to-date summary of the results of recent studies. As they note, research in this area is evolving rapidly. In another contribution to the literature, UNCTAD (2004) finds that trade liberalization and expansion in the least developed countries during the 1990s did not lead to poverty reduction. It attributes this result in part to the pattern of economic growth as well as civil conflicts in some of these countries.

As women are disproportionately represented among the poor, international trade can improve employment opportunities for women. In a survey of the empirical literature on the impact of international trade on gender equality, Swamy (2004) finds that increasing trade is generally associated with narrowed gender wage gaps. However, for a country to maximize the gains from trade, she illustrates that education, skills acquisition, and a nondiscriminatory labor market are also needed. In Sub-Saharan Africa, a particular consideration is enhancing female farmers’ control over resources so they can fully reap the benefits from trade expansion.

Overall, the literature emphasizes macroeconomic approaches and is narrowly focused on trade policy. This approach is insufficient at a number of levels—not the least of which is the magnitude of the impact when trade policy is the solitary focus. The fact is that direct effects may be quite small; therefore, researchers need to look at other factors that can affect the ability of individuals to take advantage of the opportunities offered by more open trade regimes such as their access to markets. The other important factor is that trade policy is never conducted in isolation from other policies. These other factors may actually have greater impact on the poor and thus, the role of trade policies needs to be put in relative context. Finally, the consensus also appears to be moving towards the need for more emphasis on tools that help measure the micro effects on firms and households of macro policies including trade (Hertel and Reimer 2004). In particular, they note the importance of better understanding how factor markets, notably labor, work given that it is the most important asset of the poor.