4 Outcomes and Results

This chapter first analyzes outcomes at the **project** level, assessing the extent to which project objectives were met.

Then, using a broader set of trade and macroeconomic outcomes at the **cross-country** level, it compares countries that borrowed from the Bank to a control group of countries that reformed without the financial assistance of the Bank, to capture outcomes such as trade performance, export diversification, and greater integration into the global economy. Finally, the chapter examines results at the **country** level, drawing on case studies commissioned by IEG.

Project Outcomes

What Were the Objectives?

Figure 4.1 shows that improving incentives for tradables and achieving macroeconomic stabilization and economic growth were almost equally important objectives for adjustment loans with trade components. Promoting and diversifying exports was the most important objective of investment loans and the third most important for adjustment loans.

How Did the Projects Perform?

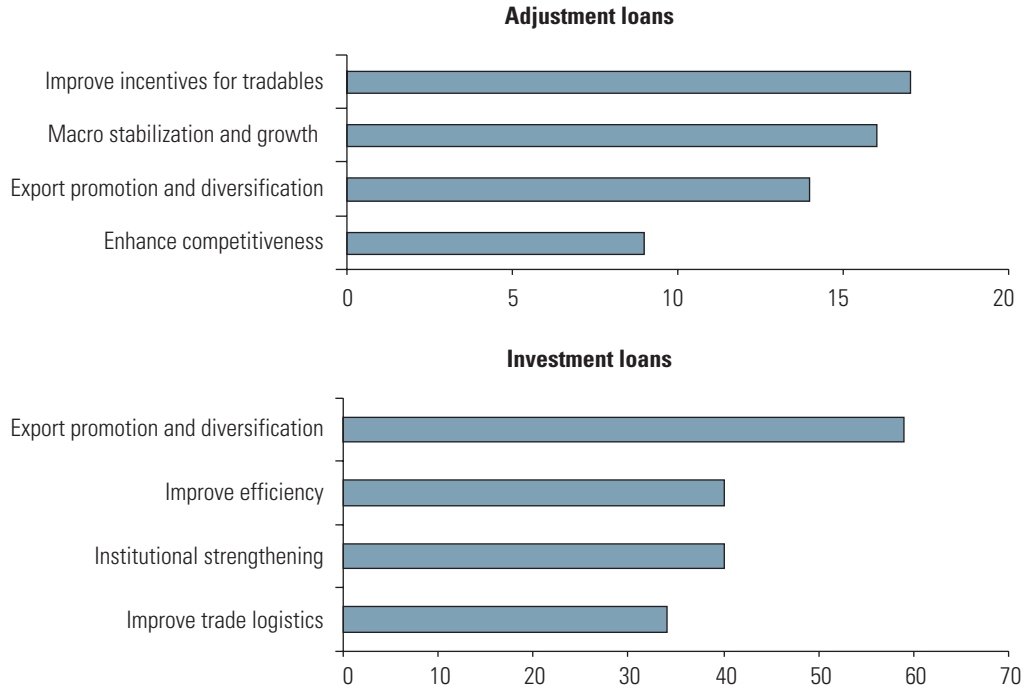
Of the 215 operations with trade-related components exceeding 50 percent that the Bank approved between fiscal years 1987 and 2004, 132 had closed and been rated by IEG (about 57 percent of all projects, or 59 percent in terms of value) as of April 2005.

Trade loans focused on improving incentives for tradables, diversifying exports, macroeconomic stabilization, and economic growth.

Core trade lending operations (in which trade components accounted for more than 80 percent of project costs) performed about the same as the rest of the Bank portfolio over the period on outcome and sustainability, but worse on institutional development impact. They yielded a *satisfactory* outcome rating 70 percent of the time,[1] slightly lower than the percentage of overall Bank lending operations rated satisfactory between 1987 and 2004. In general, trade adjustment loans performed better than other adjustment loans (86 versus 78 percent), while trade investment loans performed slightly worse than other investment loans (69 versus 72

Trade lending performed as well as the rest of the Bank portfolio on outcomes and sustainability, but worse on institutional development impact.

Figure 4.1: Stated Objectives of Trade-Related Projects, 1987–2004 (frequency cited)



Source: IEG staff calculations.

Note: Only loans approved between 1987 and 2004 in which more than half the components focused on trade were considered. Adjustment loans = 42; Investment Loans = 173. Because loans frequently have more than one objective, the frequency with which objectives appear exceeds number of loans.

percent, respectively). The trade portfolio had a *likely* sustainability rating 64 percent of the time, slightly higher than the average for all Bank operations.

In contrast, trade operations achieved a *substantial* institutional impact only 29 percent of the time over the review period. This is significantly lower than the Bank average of 42 percent over the same period, but is driven by extremely poor performance in the late 1980s and early 1990s. Trade adjustment and investment loans each performed worse than the Bank portfolio. In line with Bank lending operations in other sectors, all evaluated dimensions of trade-related operations have improved steadily over time.

Projects focused on different thematic areas in trade have performed differently, but overall performance has improved over time.

The relative importance of trade in any project did not generally make an appreciable difference in its performance (Appendix D1). The overall ratings were comparable in all dimensions for projects with smaller trade components (between 50 and 80 percent trade component share), with the notable exception of the institutional development rating, which was substantially lower for core trade projects (29 percent as against 71 percent).[2]

Components that focused primarily on trade liberalization achieved the best performance outcome ratings: 85 percent were rated satisfactory (Appendix D2). Components related to private financing (such as export finance guarantees and export reinsurance) were the least successful, with only 56 percent rated as satisfactory.

The superior performance of projects focusing on trade liberalization reflects the relative legislative ease (the so-called "stroke of the pen" actions)[3] of putting in place the associated actions (such as the reform of tariff regimes, reduction and elimination of import and export licenses or bans).

By contrast, the thematic areas that make greater demands on institutional and administrative capacity are more difficult to implement. Failure to address key supply-side constraints can ultimately short-circuit export expansion, even if trade liberalization is accomplished.

Appendix D3 summarizes the performance of three key groups of trade-related investment projects: customs, export processing zones (EPZs), and matching grant schemes. Transport-related trade facilitation projects are the subject of two ongoing IEG evaluations of Regional integration and transport.

An econometric estimation of the determinants of project outcomes at an aggregate level suggested that country and loan characteristics were important. Middle-income countries and those with low conditionality had a higher probability of having better-performing loans. The probit estimation also confirmed that project implementation had improved over time (Appendix D4).[4]

In addition to per capita income, other country characteristics were important determinants of trade project outcomes. The Country Policy and Institutional Assessment (CPIA) index was used as a proxy for a country's institutional and policy capabilities.[5] In the trade portfolio, unsatisfactory lending operations were more likely to be associated with countries with lower CPIAs than were satisfactory lending operations. This holds true for both core trade and other trade-related projects. Performance in projects that focused exclusively on trade did not differ as much between countries with low and high CPIAs. This suggests that these projects made relatively lower demands on the client countries. In contrast, multisector loans with trade components were more complex, required greater capacity, and were thus more likely to pose a greater challenge for countries with low CPIAs. Projects implemented in the transition countries were also likely to have poorer performance, driven by exceptionally poor performance of trade finance loans.

Country income and policy characteristics were important determinants of trade project outcomes.

The existence of economic and sector work (ESW) underpinning a trade lending operation appeared to have positively affected the outcome. Lending operations that

ESW affected project outcomes positively.

Box 4.1: Trade Finance—A Continued Struggle to Be Effective for Some

The overall outcome of a variety of trade financing loans (lines of credit, pre- and post-shipment credits, export credit and guarantee schemes) was unsatisfactory in a range of countries (Bangladesh, Bolivia, Guinea, India, Romania, Tunisia, and Turkey). Based on project evaluation documents, the most common reason for their relative lack of success was an over-estimation of demand. This may have arisen partly because the projects failed to consider competition from other, cheaper (often subsidized) sources that created a distorted market for term finance. Reform of the financial system is a prerequisite for provision of these lines of credit and, more generally, other sources of finance (such as multilateral or bilateral donors) should be considered. Two other factors that help explain the performance of the trade financing loans were cumbersome implementation arrangements and macroeconomic conditions that were not supportive (such as high and variable inflation and overvalued exchange rates).

These lessons, which were captured in guidelines introduced in the Bank's Operational Directive for Financial Sector operations in 1992, were not embedded in subsequent trade finance projects, though lower inflation rates in the mid- to late 1990s did improve the environment. These projects continue to exhibit mixed performance, however. Several of these loans went to transition clients where there was weak capacity in the implementing banks and where more unstable macroeconomic conditions skew the results—operations with non-transition clients have performed much better.[a]

Source: Lindahl 2004.

a. IEG 2005 points out that while lines of credit were approved in relatively stable macroeconomic conditions, 20 of the 29 approved lines of credit that did not meet this criterion were in the Europe and Central Asia Region.

were rated unsatisfactory were more likely to lack any preceding ESW in the years before the operation. By contrast, projects that were rated as satisfactory were much more likely to have benefited from recent ESW (up to two years preceding the operation). Conducting ESW in advance of the trade reforms may have offered an opportunity to sensitize country officials to the need for reform and to provide the Bank with a greater awareness of potential political difficulties. Prior ESW also often addressed the fiscal implications of trade reform, perhaps enabling the Bank to better discuss alternatives to generate revenue-neutral outcomes and to minimize a common source of country reluctance to liberalize. This point is further detailed in the case study discussion.

A review of trade operations that were rated unsatisfactory or highly unsatisfactory showed some common causes of failure. Poor project design, unrealistic assumptions (related to targets and projections), and unfavorable macroeconomic environments were most frequently cited as the cause of unsatisfactory outcomes (table 4.1). Unsatisfactory loans were more likely to be associated with investment loans, with the likelihood of this rising after 1995. No Regional patterns emerged.

Conclusions. Projects that focus primarily on trade perform about the same as the rest of the Bank portfolio on outcome (70 versus 73 percent) and sustainability (64 compared to 61 percent), but worse on institutional development (29 percent of core trade projects compared with 42 percent for the Bank).

The performance of the trade portfolio has improved over time, in line with the rest of the Bank. The degree to which a project contains trade does not make an appreciable difference to outcomes.

Projects that focused on thematic areas that make greater demands on institutional and administrative capacity, such as trade financing, performed the worst, making it more difficult for the Bank to achieve its institutional-strengthening objectives.

At an aggregate level, positive project outcomes were associated with middle-income countries, low conditionality and good institutional frameworks, and prior ESW.

At a project level, poor project design, unrealistic assumptions, and unstable macroeconomic environments contributed most frequently to unsatisfactory outcomes.

Did Trade Loans Pay Attention to Poverty and Distributional Issues?

As noted in Chapter 2, critics of the Bank have been particularly concerned about the adjustment costs associated with trade liberalization. IEG's review of project design found that trade-related adjustment loans have not paid sufficient attention to potential adjustment costs from trade liberalization or to the

Table 4.1: Factors Underlying Poorly Performing Projects

Thematic focus	Closed (before 1995)	Closed (after 1995)
Unrealistic assumptions	2	8
Project design	0	9
Macroeconomic conditions	4	8
Borrower administrative capacity	2	5
Weak borrower ownership	2	4
Political developments	2	2
Memo:		
Number of unsatisfactory projects[a]	10	20
Total projects > 50% trade	43	172

Source: IEG staff calculations from project documents.

a. Unsatisfactory or highly unsatisfactory trade loans with trade component exceeding 50 percent of total project costs.

functioning of labor markets, despite heavy emphasis on poverty in the 1990 and 2000–01 *World Development Reports*.[6] The latter WDR acknowledged trade liberalization had yielded ambiguous results for the poor over the past 15 years, and that the initial push for trade liberalization as an instrument for poverty reduction had been influenced by a "narrow reading of predictions from trade theory: that removing trade barriers in developing countries would increase demand for their abundant low-skilled labor and expand unskilled employment and earnings"(World Bank 2001b, p. 70).

Between 1987 and 1995, 31 percent of trade adjustment loans included compensation or mitigation measures to cushion the social and economic effects of trade reform on the poor. Since then, 38 percent—a slight increase—of trade adjustment loans have done so. The nature of the measures ranged from targeted subsidy programs to supplement the caloric intake of the poor in Mexico[7] to the introduction of social safety net measures to protect the unemployed during the period of transition.

The Bank also supported some safety nets through separate adjustment credits, such as in India's National Renewal Fund, which provides a social safety net to cover the labor costs of restructuring and to mitigate its employment effects. The failure of trade-related ESW to analyze the links was also a contributory factor, given the importance of quality analysis for well-performing lending.

IEG finds little evidence that more recently approved trade-related lending operations are doing a much better job of identifying potential winners and losers or of integrating adjustment assistance strategies. Even in cases where projects build on analysis of poverty considerations, implementation is sometimes unsuccessful in mitigating the associated adjustment costs.

Economic Outcomes for the Sample Countries

The cross-country sample analyzed in this section comprises 45 developing countries that had a complete set of trade and macroeconomic data for a period of 10 years (2 years before the trade reform and 8 years afterward). The date of reform was ascertained based on a review of Bank reports and outside research, as well as discussions with country economists where necessary. The sample excludes countries that were in conflict during the period, as well as the republics of Eastern Europe and the former Soviet Union that were in transition.

Trade-related adjustment loans have not sufficiently attended to poverty and distributional outcomes.

The 45 countries include 2 groups: 35 countries that undertook trade reform with the support of a Bank loan, and 10 countries that undertook trade reform without a Bank loan during this period. The countries are additionally classified according to several dimensions: (i) whether they were gradual or fast reformers; (ii) whether they were intensive reformers undertaking deep reforms in several areas or less intensive; (iii) Bank geographical Region; (iv) export structure; and (v) per capita income. Appendix D5 and Jinjarak and others (2005) provide additional detail and description.

A sample of 45 countries that undertook trade reform provides a cross-country view of economic outcomes.

Initial Conditions

The conditions prevailing at the time of trade reforms in the 35 liberalizing countries supported by the Bank often constituted a bias against trade and reflected unstable macroeconomic conditions. The introduction of trade reform in the presence of macro instability was consistent with the consensus from the literature, but differed from previous IEG analysis, which views stabilization as a prerequisite (IEG 1992a).

With average tariffs on goods above 30 percent and nontariff barrier (NTB) frequency ratios[8] above 50 percent, the 45 countries in the sample would be considered highly protected by any standard. Their import duty regimes were also characterized

Bank clients tended to have more unstable initial macro conditions and greater anti-export bias.

by various forms of restrictive import licensing arrangements, and "cascading" tariff structures, all contributing to high effective protection and a wide dispersion in protection.

On the export side, these 45 countries frequently applied restrictions to export activities (export bans, export licenses) and introduced repatriation requirements related to export profits. Particularly in Africa, major export commodities were governed by government marketing monopolies. Exchange rates were often fixed at official rates and overvalued, resulting in the emergence of black market premiums in some countries as foreign exchange shortages arose. These policies constituted a major bias against exports.

The 35 reformers supported by the Bank had slightly higher initial import tariff levels (31.9 versus 27.6 percent, on average, for unweighted tariffs, and 21.6 versus 25.8 percent for weighted tariffs reflecting exemptions) than non-Bank-supported or independent trade reformers. However, even this figure is misleading as it masks their much greater use of nontariff barriers—almost 70 percent of tariff lines compared with 23.9 percent for the 10 independent reformers.[9]

Changes in Target Variables and Economic Activity

Impact of policy reforms on target variables (tariffs and protection)

On average, countries that borrowed from the Bank for trade reform tended to have larger initial fiscal deficits when compared with countries that undertook reforms on their own, and they relied slightly more on import duties as a source of tax revenues (table 4.3).[10] Bank borrowers had lower investment and economic growth rates. Bank clients also faced greater precariousness in their foreign trade regimes, reflected in higher external debt-to-GDP ratios and lower foreign exchange reserves. The economic imbalances of the Bank's clients were often associated with balance of payments difficulties, presaging their tendency to borrow from the Bank.[11]

This section examines the performance of developing countries at an aggregate level to assess the achievement of objectives. Specifically, it examines the impact of the policy actions discussed above on the directly targeted policy variables (such as tariffs), on economic incentives, and on economic activity in the real sector—major objectives of the Bank's assistance on trade such as exports and growth. In addition, we attempt to delineate the role of the Bank in this process by using a "difference-in-differences" approach to correct for any potential sample selection bias. Given the pervasive trend toward trade liberalization among developing countries during the review period, a second counterfactual (comparing trade reformers to non–trade reformers) was not explored.[12]

A word about attribution: while other actors were important in influencing trade policies in developing countries (such as the IMF, and more recently the WTO and regional trading arrangements), for the period during which most of the sample countries liberalized with support from the Bank (mid-1980s to early 1990s), the Bank was the predominant advisor on trade policies. This is borne out by a review of the trends in IMF trade conditionality and an examination of the nature of Bank trade conditionality during this period.

Another dimension that is more difficult to capture is the impact of the existence of a Fund program. While econometrically this did not generate additional results, to the extent that a Fund program contributed to good macroeconomic outcomes or to the perception of good macroeconomic management, this is likely to have contributed to greater support by development partners, helping to ease macroeconomic imbalances.

All groups of countries in the sample of 45 reformers generally showed a trend toward more openness in terms of lower tariffs (table 4.2), although the pace differed, with notably slow liberalization by countries that started out with a larger manufacturing base. Trade reform was significant across all Regions, although significant NTBs remain in Africa, East Asia and the Pacific, and the Middle East and North

Table 4.2: Indicators of Protection

Region	Simple unweighted tariff (%)			Weighted tariff (%)[a]			Nontariff barriers (% of lines)		
	t = 0	t = 1	t = 2	t = 0	t = 1	t = 2	t = 0	t = 1	t = 2
All reformers	30.4	27.9	20.8	24.6	12.7	7.0	59.1	42.1	17.2
Bank-supported	31.9	29.1	23.1	21.6	10.9	10.2	69.9	44.1	17.4
Independent	27.6	21.0	14.7	25.8	13.4	5.7	23.9	14.6	5.1
By Region									
Africa	18.2	24.7	18.1	16.9	12.2	6.4	57.0	36.1	41.3
East Asia and Pacific	32.8	23.1	21.4	17.9	12.5	11.9	38.0	42.2	25.6
Europe and Central Asia	22.7	9.5	8.3	..	..	3.9	96.4	96.4	9.4
Latin America and the Caribbean	25.9	13.5	12.5	35.6	12.4	6.4	33.6	18.6	6.6
Middle East and North Africa	26.0	25.0	26.8	..	14.9	10.0	63.7	63.7	27.6
South Asia	66.0	48.0	31.6	49.8	14.7		74.3	48.8	21.5
By income									
Low-income	34.5	29.2	24.7	31.0	12.3	5.4	66.1	40.3	9.2
Middle-income	28.7	27.1	18.2	19.8	13.0	8.0	45.6	37.3	17.5
Reform intensity									
Intensive	30.7	21.7	21.7	21.1	15.1	8.4	57.3	62.6	24.8
Non-intensive	30.6	29.4	20.7	25.1	12.1	6.4	56.0	33.8	12.9
Reform pace									
Gradual	27.6	27.1	23.2	32.1	12.7	8.6	56.9	45.8	15.3
Fast	34.3	28.8	18.9	14.5	12.7	5.0	55.3	31.2	15.0
Initial exports structure									
Fuel	28.5	21.7	14.8	..	10.8	4.5	79.1	53.7	5.6
Manufacture	41.9	41.0	34.8	33.4	15.1	5.7	72.8	52.5	26.7
Other	29.1	24.5	19.9	18.0	12.3	7.9	52.4	35.9	14.5

Source: Jinjarak, Salinas, and Tsikata (2005).

Note: t = 0 is initial period of 0 to 2 years before trade reform; t = 1 is 0 to 2 years after reform; t = 2 is 3 to 5 years after reform.

a. This underestimates the extent of protection in earlier years because it does not include import surcharges, which were quite prevalent.

Africa.[13] While some countries in South Asia were still protected after the reforms, they made progress, actually reducing average tariffs by half and reducing NTB coverage by more than that.

While nominal tariffs are readily available and an easily comparable source of data to try and ascertain changes in protection, they can be deceptive. In particular, if countries substitute other instruments of protection, such as surcharges, overall protection may rise. While the study could not examine this for all countries, evidence from country reviews suggests instrument substitution was not uncommon (Indonesia, Morocco, Peru, Senegal).

Much like the findings from project-level data, the whole-sample data on the evolution of tariffs and nontariff barriers do not support the common criticism that the Bank followed a "one-size-fits-all" approach to trade liberalization. The pattern of trade reform was heterogeneous across countries, differing widely in magnitude.[14] Some countries in the sample (Tunisia, Vietnam) implemented a dual-scheme approach to reform, maintaining high protec-

tion of domestic industries, but providing liberal trade regimes in free trade or export processing zones.

The assertions that Bank-supported reforms were consistently more rapid and that the speed of reform was inappropriate are difficult to evaluate. There was no correlation between the presence of Bank support and the speed of reform. Independent reformers were as likely to be fast reformers as were Bank-supported reformers. Almost half (44 percent) of all liberalization episodes were rapidly implemented—that is, with most of the reform completed within three years—with the other half taking anywhere from 4 to 11 years. But by historical standards, all these liberalizations were implemented rapidly. For example, after World War II, the average U.S. tariff was slightly below 50 percent, and it took 50 years for this figure to decline to 6–8 percent.

Trade reform led to lower tariffs, and was accompanied by higher import demand and faster economic growth, but only modest export supply response.

Real sector

Independent and Bank-supported countries shared common trends (table 4.4 and Appendix D5) for the main macroeconomic and trade indicators. Both groups of countries were successful in bringing down inflation, reducing their fiscal deficits, and broadening their tax revenue bases. The introduction of trade reforms was accompanied by a significant increase in import demand, in part because these reformers had been experiencing more import compression before the reform, brought about by foreign exchange shortages and quantitative restrictions. Export growth was modest for both groups—it stayed relatively stable for Bank-supported liberalizers but slowed down for independent trade liberalizers. The current account balance increased slightly for the Bank's clients and

Table 4.3: Bank Trade Clients Differed from Other Developing Countries

	Sample countries excluding those under hyperinflation		
Trade reformers	**All**	**Bank-supported**	**Non-Bank-supported**
Macroeconomic indicators			
Real effective exchange rates (1980 = 100)	96.4	96.4	96.0
Consumer price index inflation (%)	21.7	21.0	20.4
Fiscal balance/GDP (%)	–4.1	–4.7	–2.2[a]
Tax revenue/GDP (%)	13.8	13.4	15.5
Investment to GDP (%)	19.7	18.3	24.3[a]
Per capita GDP growth (%)	0.8	0.4	1.8
External indicators			
Export growth (%)	6.1	5.3	6.5
Import growth (%)	2.3	2.4	0.6
Trade to GDP (%)	54.7	52.6	64.5
Current account balance to GDP (%)	–3.8	–4.4	–2.1
Terms of trade (1980 = 100)	99.2	98.2	102.7
Total external debt of GDP (%)	80.5	92.3	41.1[a]
Reserves in months of imports	2.5	2.3	3.1
Memo: Number of countries	45	35	10

Source: Authors' calculation from World Development Indicators (WDI) 2004 and data provided by country economists. Figures are an average of the two years prior to reform.

a. 10% statistical significance.

turned into a small surplus for the independent reformers.

There were some differences as well between the two groups of countries in other macroeconomic indicators. The investment performance of the Bank-supported reformers was positive, but not remarkable; after an initial boost immediately following the reform, the investment rate slowed. In the independent reformers group, the investment rate rose more rapidly. In both sets of countries, per capita GDP growth rose—from 0.4 percent before the reform for the Bank-supported reformers to 2 percent three-to-five years after the reform, and from 1.8 to 3.1 percent for the independent reformers.

While the combined before-and-after trade reform and with-and-without Bank assistance approach used above presents an easily understood statistical analysis, it has been criticized as a poor estimator of the counterfactual (what would have happened in the absence of the Bank-supported trade program?) because the approach tends to yield biased and unsystematic results of the effects of borrowing from the Bank.[15] To address these concerns, two econometric approaches were used. First, the significance of the differences discussed above was tested. The results, presented in table 4.4, show that the differences were statistically significant for the following variables: per capita GDP growth, imports, the current account balance, terms of trade, and the external debt-to-GDP ratio. Second, an econometric analysis was conducted that corrects for the potential sample selection bias that could potentially arise if Bank clients were to systematically differ (in characteristics) from non-Bank clients.[16]

Bank borrowers experienced larger import flows and GDP growth after liberalization, but export supply response was modest.

The results from the second exercise, discussed in detail in Jinjarak, Salinas, and

Table 4.4: Economic Indicators: With and without Bank Assistance and Before and After Trade Reform

	Trade reformers					
	All		Bank-supported		Non-Bank-supported	
Before trade reform	t = 0	t = 2	t = 0	t = 2	t = 0	t = 2
Macroeconomic indicators						
Real effective exchange rate	96.4	80.7	96.4	77.7	96.0	87.4
Consumer price index inflation (1995 = 100)	21.7	18.9	21.0	17.7	20.4	16.6
Fiscal balance as share of GDP (%)	–4.1	–2.6	–4.7	–2.6	–2.2	–2.2
Tax revenue as share of GDP (%)	13.8	15.6	13.4	15.3	15.5	16.8
Investment as share of GDP (%)	19.7	22.7	18.3	21.8	24.3	26.1
Per capita GDP growth (%)	0.8	2.2	0.4	2.0[a]	1.8	3.1
External indicators						
Exports as share of GDP (% growth)	6.1	7.4	5.3	7.8	6.5	5.7
Imports as share of GDP (% growth)	2.3	7.5	2.4	7.5[a]	0.6	7.7[a]
Trade as share of GDP (%)	54.7	64.2	52.6	64.8	64.5	65.3
Current account balance to GDP (%)	–3.8	–2.7	–4.4	–3.9[a]	–2.1	1.2[a]
Terms of trade	99.2	96.2	98.2	94.3[a]	102.7	101.7[a]
Total external debt as share of GDP (%)	80.5	74.8	92.3	85.9[a]	41.1	38.1[a]
Reserves in months of imports	2.5	3.0	2.3	2.7	3.1	3.9

Source: Jinjarak, Salinas, and Tsikata (2005).

Note: t = 0 is 0 to 2 years before reform; t = 1 is 0 to 2 years after reform; t = 2 is 3 to 5 years after reform.

a. 10% statistical significance.

Tsikata (2005) and summarized in Appendix D5, suggest that trade liberalization has a strong and often statistically significant positive impact on economic growth and imports for both the Bank's clients and other independent reformers, and that these impacts persist beyond the short term. With respect to exports, the impact of trade liberalization is more mixed. Bank-supported reformers exhibit rather modest export supply responses, while reformers not supported by the Bank fare slightly worse. So, while the existence of a Bank trade loan freed up imports and was associated with faster economic growth compared with reformers not supported by the Bank, this growth could not be attributed to faster exports growth.

Contribution of trade to growth

Following Chenery (1979), variations in output growth were disaggregated into demand factors—domestic demand, import substitution, and export expansion—for the periods before and after the year of reform for the 45 countries in the sample.[17] Appendix D6 presents the results. Three points can be made:

Relatively speaking, import demand made a larger contribution to economic growth.

- First, domestic demand is a major source of growth for the developing countries in the sample. In all but six countries for which the calculation was done, domestic demand was by far the largest contributor to output growth, explaining more of the increase in growth than either export expansion or import substitution.
- Second, before reform, the reverse of import substitution—import penetration—was more prevalent. After reform, while the degree of import penetration increased in a few countries, the more common pattern was declining import penetration, which was sufficient to reverse the pattern to one of import substitution in some countries.

Export diversification was modest, especially for the Region with the highest initial concentration—Sub-Saharan Africa.

- Third, the importance of export expansion was uneven across countries following trade liberalization. In half of the countries it increased, while in the other half it declined in importance.

Diversification of exports

Diversifying the export basket has been an important objective of the Bank's assistance. Table 4.5 provides three measures of progress in export diversification: the number of products exported, an export concentration index, and the share of a country's top three exports in the overall export basket. Two points emerge. First, all three measures suggest a reduction in export concentration for developing countries as a group and across the major groupings of income, Bank trade loan or not, and regardless of the intensity of reform. Second, despite the overall progress, the Africa and the Middle East and North Africa Regions continue to have extremely concentrated export baskets, and Africa lags well behind the other Regions.

Another way of examining progress in diversification is through an "exports prospects index." Developed in Ng and Yeats (2003), this index helps gauge how favorable (or not) prospects are for a country's exports baskets. An index above one suggests above-average growth prospects, while a value below one suggests the converse. In an estimate of the index for 26 African countries, the authors find only one African country (Mauritius) whose export basket currently suggests that it has the potential to grow at about the same rate as world trade.[18] Given the well-documented (see, for example, Page and Hewitt 2001) continuing secular decline and volatility of commodity prices relative to manufactures and services, there is an urgent need for African countries to reduce their commodity dependence in the long term with the help of transitional assistance.

Both supply and demand factors can influence trade performance. Export growth in the sample of 45 countries between 1982 and 2003 was decomposed into demand, competitiveness, and diversification changes.[19] The results for the analysis at the three-digit Standard International Trade Classification

Table 4.5: Changes in Export Concentration—Half-Full or Half-Empty?

Group	Number of products exported[a]		Export concentration index[b]		Share of three largest exports in total exports (%)	
	Pre-reform	Post-reform	Pre-reform	Post-reform	Pre-reform	Post-reform
All	137	142	0.32	0.31	44.3	38.5
Africa	92	92	0.40	0.41	59.6	54.4
East Asia and Pacific	195	193	0.19	0.20	18.3	14.3
Europe and Central Asia	205	212	0.12	0.12	6.2[c]	4.5[c]
Latin America and the Caribbean	144	154	0.33	0.31	34.4	30.6
Middle East and North Africa	156	156	0.24	0.21	24.4	24.0
South Asia	137	134	0.30	0.27	8.5	11.5
By income						
Low-income	152	160	0.29	0.27	31.6	27.8
Middle-income	110	109	0.37	0.36	56.3	49.6
Reformers						
Bank-supported	137	143	0.35	0.34	57.3	51.8
Independent	136	141	0.31	0.30	41.8	36.0

Source: IEG estimates based on UNCTAD 2004.

a. Number of products exported at three-digit SITC, revision 2 level; this figure includes only products that are greater than $100,000 or more than 0.3 percent of the country's total exports.

b. The Herfindahl-Hirschmann index is a measure of the degree of market concentration. It has been normalized to obtain values ranking from 0 (least) to 1 (maximum concentration).

c. Turkey only.

(SITC) level are presented in table 4.6. The table suggests that the overall diversification contribution to export expansion was minimal across different groups of developing countries, with China dominating the results when included in a group. The table shows that experience varied significantly across Regions and groups of countries. East Asia was the only geographic Region in which gains in competitive position underpinned export performance. Competitive gains were notably low in Africa, and in over half of the African countries the competitive position actually deteriorated. Aggressive and more rapid reformers were more likely to experience greater competitive gains relative to demand.

Did deindustrialization occur?

As discussed in Chapter 2, a criticism of Bank advice on trade liberalization is that it has led to deindustrialization. Table 4.7 and Appendix D5, table D5.2d, present summary statistics on export performance and manufacturing value added (the latter used as a proxy to measure deindustrialization between 1983 and 2003).

The tables suggest that in 11 countries with the highest overall export growth (averaging 12.8 percent), manufacturing value added grew at the respectable rate of almost 7 percent. In contrast, 23 countries with medium export growth rates (about 7 percent) experienced modest growth in manufacturing value added and overall GDP growth, despite growth in manufacturing exports; indeed, manufacturing value added fell over time. This suggests that the gains in manufacturing exports in this group represented a diversion from domestic markets and that some degree of deindustrialization had occurred. Exceptions to this pattern were Chile, Indonesia, and Mauritius.

Internal efficiency gains and productivity

The evaluation conducted a literature review of country experiences with trade and productivity

Table 4.6: Factors behind Change in Exports: By Country Groups (US$ million)

All countries	Exports (annual average) 1982–85	2000–03	Change	Factors underlying change: Overall demand	Competitive factor
All countries	126,768	680,980	554,212	220,313	333,899
Region					
Africa	19,060	37,316	18,256	17,790	466
East Asia and Pacific	34,894	391,832	356,938	91,655	265,283
East Asia and Pacific, excluding China	27,936	208,105	180,169	79,595	100,573
Europe and Central Asia	4,494	18,272	13,778	9,667	4,112
Latin America and the Caribbean	56,940	186,965	130,025	76,221	53,804
Middle East and North Africa	3,314	10,682	7,368	6,291	1,077
South Asia	8,066	35,913	27,847	18,689	9,157
Intensity of reforms					
Low-intensity reformers	112,986	455,556	342,571	195,438	148,584
High-intensity reformers	13,782	225,424	211,641	24,876	186,766
High-intensity reformers excluding China	6,825	41,697	34,872	12,816	22,056
Pace of reforms					
Gradual reformers	61,504	385,007	323,503	99,861	223,642
Gradual reformers excluding China	54,547	201,281	146,734	87,801	58,933
Fast reformers	65,264	295,973	230,709	120,452	110,257

Source: IEG estimates based on United Nations COMTRADE Database.

Note: The demand factor isolates the effect of the increase or decrease in global demand for sample country exports. It shows the percentage increase or decrease in exports that would have occurred had there been no change in the countries' import market shares from the 1982–85 base period. The competitive factor shows the percentage change in exports over or under that associated with demand changes that is brought about solely by the introduction of new products. Any differences between changes in a country's total exports and the sum of these "demand" and "competitive" changes are the result of product diversification.

gains. Because of data constraints, this issue is not well researched for all developing countries, especially less-developed countries. However, countries that have been studied overwhelmingly experienced positive gains in productivity growth following trade liberalization, either as a result of reductions in output tariffs or tariffs on intermediate goods.[20]

Liberalizing countries experience productivity gains.

Lessons at the Country Level

Six country case studies were conducted for this evaluation—of India, Indonesia, Morocco, Mozambique, Senegal, and Zambia. The studies covered fiscal years 1987 through 2003 and 47 lending operations. This section summarizes the lessons that can be generalized to the Bank's trade activities (Appendix D7 summarizes the case studies).

In all case study countries, tariffs were lowered in the medium term, and foreign exchange reserves positions improved (although aid often played a part). Economic outcomes were mixed. India, Indonesia, Morocco, and Mozambique enjoyed higher GDP growth, as well as revenue gains. Nontraditional exports were diversified in some countries (Indonesia, Senegal, Zambia), but export growth was often uneven. In general, results with respect to the sustainability of reforms, the implementation pace, investment response, and productivity gains differed widely. Employment losses occurred in the

Table 4.7: Export Growth and Increased Value Added, 1983–2003 (annual increase, percent)

	Manufactured exports adjusted for purchasing power	Total exports adjusted by purchasing power	Value added by manufacture	Total value added
By growth				
High export growth	11.9	12.8	6.6	5.5
Medium export growth	11.4	7.3	3.0	3.2
Low export growth	7.2	3.0	2.1	1.9
By income				
Low-income	10.6	7.6	3.8	3.3
Middle-income	10.5	7.2	3.5	3.4
By speed of reform				
Gradual	9.5	7.2	4.1	3.7
Fast	11.6	7.4	2.8	2.8

Source: IEG staff calculations from 3-digit SITC data.

cashew industry in Mozambique and in manufacturing in Senegal and Zambia. A closer look at the main lessons helps explain the varying outcomes.

Crises Can Precipitate Reform, but Broad Ownership Sustains It

In the six case study countries, macroeconomic or financial crises precipitated the initial trade reform, whether supported financially by the Bank or not.

In **Zambia**, a crisis was compounded by political change. Subsequent reform was often driven by a move toward regional harmonization, notably as countries joined various regional trading arrangements (**Morocco, Senegal**) or by multilateral WTO obligations (**India**).

India, Indonesia, and **Morocco** exhibited a high degree of ownership. This manifested itself in trade policy reforms that sometimes did not follow exactly the Bank's analytical advice or loan design to better adapt them to the country's political economy. Strong ownership was also characterized by a willingness to go beyond the Bank's recommendations in some aspects.

In **Zambia**, the early days of the reform were marked by strong ownership from a new political party eager to make a break with the socialist past and to signal donors and investors that the business environment had improved. Thus, a broad range of reforms were undertaken from the start. But over time, ownership of the reforms became diluted and reforms took longer to implement.

Country case studies and desk reviews of selected programs provide additional insight into Bank support for trade.

In **Senegal**, despite a history of policy reversal, a coalition of pro-reform elements in the public and private sectors was instrumental in keeping the reform agenda going. One lesson for advising on a reform program during crisis is that it pays to have in-depth knowledge of the economy from earlier ESW (as in India, Indonesia, and Morocco).

Crisis can precipitate reform, but broad ownership sustains it.

Sequencing of Macroeconomic Policies

While the Bank's initial diagnosis of the issues constraining trade development in the case study countries was generally correct, in some cases the sequencing of macroeconomic, trade, and other structural policies was suboptimal. In particular, some countries kept one foot firmly on the accelerator (liberalizing trade), and one foot on

Poor policy advice and poor implementation sabotaged trade reform in some cases.

the brake (overvaluing their currency).[21]

In **Senegal**, the persistent overvaluation of the currency in the late 1980s and early 1990s meant that Bank recommendations to liberalize trade were premature. In **Morocco**, failure to consider alternative sources of revenue to replace losses from lowering tariffs led to fiscal distress and a reversal of trade liberalization. Subsequently, the real appreciation of the Moroccan dinar during the 1990s made it more difficult for the country to compete.

Failure to conquer fiscal constraints also proved to be a stumbling block for India and Senegal by making those countries more cautious about the pace of reform. In **Zambia**, the 1990s were characterized by adverse macroeconomic conditions (high real interest rates, a tendency toward a volatile and overvalued exchange rate), general instability, and a banking sector that financed government deficits rather than private investment.

The Enhanced Structural Adjustment Facility (ESAF) review by the IMF (Botchwey and others 1998) highlights the finding that the sequencing of macroeconomic policies recommended by the IMF and the Bank contributed to the poor macroeconomic outcomes in Zambia. With rising inflation and liberalized interest rates, there was a liquidity squeeze that drove real interest rates up to high levels. This, in turn, caused real exchange rate appreciation that, in conjunction with the rapid trade liberalization, placed Zambian firms under intense competitive pressure. The failure to achieve macro stabilization proved costly.

The Need for Complementary Policies Was Underestimated

The Bank was generally aware of the importance of complementary policies on the regulatory side, often incorporating them in its lending to the countries. Yet implementation in these areas was often weaker than those actions linked directly to trade policy. The evidence from the country case studies suggests that the Bank may initially have underestimated the complexity of the regulatory reforms and the political constraints associated with carrying them out. The failure to complete these reforms in a timely fashion affected the outcomes from trade reform negatively in some cases. Moreover, the most critical complementary policy varied across countries, suggesting the need for in-depth analytical work.

The complexity of complementary policies was underestimated.

In other cases where the authorities were interested in introducing reforms, the Bank was able to craft a comprehensive program of assistance to complement trade reform. In **Morocco**, the Bank adapted to its reduced role in trade policy and was able to use its ESW to identify the most pressing supply-side issues and make a convincing case for reform (for example, in customs). In **India**, Bank staff saw industrial deregulation and trade liberalization as mutually reinforcing; thus, its analytical work and lending operations tackled both.[22] In **Indonesia**, the Bank financed a cluster of projects that complemented trade reform and addressed supply-side issues. These included a manpower and training development project, two export development loans, an industrial restructuring loan, and a loan for private sector development.

Apart from regulatory reforms, the studies on **Senegal** and **Zambia** identified skills shortages, notably at the technical and managerial levels, as important constraints to improved global competitiveness. The potential positive role of high-quality economic and sector work was also addressed in all case studies (see box 4.2 and Appendix D7).

Institutions Matter and Underpin Sustainability

Institutions that facilitate trade policy and development and ensure implementation are important in carrying out the strategic vision of countries. In **Morocco**, Bank lending and technical assistance to a variety of institutions (Ministry of Commerce and Industry, Port Authority of Morocco, customs administration) is widely viewed as having been highly effective—having led to strengthened strategic and regulatory capacity. The Moroccans

Box 4.2: Failure to Implement Complementary Policies Can Be Costly

In **Zambia,** the privatization of the mining parastatal Zambia Consolidated Copper Mines (ZCCM) was an important element in the trade reform program. When Zambia initiated its reforms in 1991, it was still dependent on copper for over 90 percent of merchandise export revenues. ZCCM was an inefficient producer and a drain on the national budget. Although the new reformist party had advocated the reorganization of ZCCM, including the options of "divesture, joint ventures and privatization" in the New Economic Recovery Programme (1992), the formal decision to privatize was only announced in 1995.

By 1996–99, ZCCM was suffering catastrophic losses, equivalent to 6-10 percent of GDP yearly (Zambia Country Assistance Evaluation). Yet privatization dragged on and conditionality was ineffective. Apart from the economic costs, Zambia's slowness in implementing the recommended policies jeopardized the trade reform program and its outcomes by reducing the credibility of the government's commitment to reform. Other interventions intended to complement the trade reform probably came too late—they included an agricultural sector investment project (approved three years after the liberalization) and an enterprise development project (approved six years after the reform) or were ineffective (for example, the duty drawback scheme remained inefficient despite being the subject of conditionality in two different loans).

Source: Zambia Country Case Study for IEG Trade Assistance Evaluation.

emphasized that Bank success came about in part because (i) the government was convinced that those institutions had become a drag on the economy and (ii) each of the reforms took place at a time of crisis. Each of these institutions has been critical in Morocco's path toward global competitiveness.

In **Mozambique**, the government signed a contract with a pre-shipment inspection agency while it strengthened its own customs administration. The inspection agency was successful in tightening and improving import duty collection.

In **Indonesia**, the interdepartmental team known as Team Tariff (not financed by the Bank) was an important mechanism for reviewing all changes in import taxes and regulations. It helped put limits on the ability of particular ministers or government officials to make arbitrary changes for the benefit of particular groups.

In countries with weaker capacity, such as **Senegal** and **Zambia**, the plethora of trade issues on the negotiating agenda at the regional and global levels overwhelms under-resourced and under-staffed technocrats. Countries are unable to present positions unique to their countries. The consequence is often failure to keep up with policies and agreements that have implications for exporters, leading to resistance when the costs of the agreements are felt.

Both private and public trade-related institutions matter in carrying out reforms.

The private sector also sometimes lacks capacity. Efforts to nurture public-private partnerships as well as private sector associations can pay off in broadening the support for reform (**India**, **Senegal**), but the Bank has only infrequently supported private exporter groups (it has more frequently supported individual exporters through matching grant facilities).

External Factors Were Largely Understudied

In general, Bank country assistance strategies and country economic reports did not take adequate account of external factors such as the multilateral trade negotiations under the Uruguay and Doha Rounds or multilateral trade institutions, agreements, and rules emanating from the various WTO agreements.

In **Senegal**, according to policy makers, special conditions that apply to developing countries (such as more lenient tariff reduction schedules or flexibility in food security–related trade areas) were infrequently discussed. Despite the enormous amount of Bank research on these topics and significant advice and technical assistance from other development partners, these issues passed largely unnoticed in the Bank's

External factors were largely understudied.

country-level dialogue until 2003, when tariff and nontariff barriers in foreign markets (horticulture, fisheries), standards information and compliance, and low world cotton prices were systematically analyzed to assess their impact on Senegal.[23]

In **India**, Bank reports on the country in the late 1980s and early 1990s rarely analyzed foreign investment in depth, although the China experience had already underscored the importance of foreign investment liberalization, and even though liberalization in services trade was a major emerging issue in the Uruguay Round and necessarily required some easing of the rules on foreign investment.

In **Zambia**, the Bank failed to consider the country's complex trading environment, which arose in part from overlapping preferential trading arrangements. Zambia had to grant preferential access to final products from Common Market for Eastern and Southern Africa (COMESA) trading partners such as Zimbabwe. At the same time, Zambian manufacturers had to try to compete while importing inputs from non-COMESA sources. The result was very low—or even negative—effective rates of protection.

Distributional outcomes get too little attention.

In another example, at the time of its democratization in 1994, South Africa (a new member of Southern Africa Development Community [SADC], but not COMESA) maintained high import barriers, while subsidizing its exports through its general Export Incentive Scheme.

Although it cannot be determined precisely how serious these regional problems were, strategically Zambian policy makers felt they would have been better placed if they had "more" to bargain with (in terms of tariff reductions) when it came to subsequent free trade arrangements with COMESA and SADC. Zambia, however, had already liberalized significantly in the context of Bank projects.

Until recently, Bank advice on particular products was given in isolation from the global industry. In **Mozambique**, the controversial liberalization of the cashew nut industry did not lead to the intended beneficiaries (the farmers) receiving as great a share of the export price as anticipated. The Bank's analytic work did not systematically examine the cashew's global value chain, yet the entire thrust of the proposed reforms was to raise the international competitiveness of the industry and, with it, the farmers' share in the export earnings. Increasingly, however, the Bank's Private Sector Development Vice-Presidency is encouraging and broadening the inclusion of value chain analysis; the integrated trade logistics work in **Morocco**, for example, includes value chain analysis.

Distributional Outcomes Get Too Little Attention

A review of project documents, ESW, and assistance strategies generally found little evidence of consistent or widespread attention to the distributional outcomes arising from trade liberalization in the case study countries. Even where the Bank incorporated distributional concerns, it was hampered by poor implementation. In **Senegal**, the Bank was sensitive to authorities' concerns about the social costs of adjustment in the run-up to the devaluation and included a component in the 1994 post-devaluation Economic Recovery Credit. The IEG assessment of the credit, however, found that a well-planned safety net was missing, and that targeting was not refined enough to reach the people who most needed assistance.

Conclusions. While the initial impetus for trade reform is often an economic crisis, sustaining the reform requires broad support and ownership. Conditionality was generally not conducive to achieving that ownership, and the Bank was more judicious in using it in larger countries. Bank advice and analytical work were often instrumental in supporting reform. Its value, however, was reduced in cases where it was perceived to be dogmatically based.

Bank advice and lending contributed to systematic reductions in protection and in opening up economies, although the pace differed across countries. The long-term outcome in poorer countries' export supply response was less than expected, even when

there were short-term gains in economic growth. As discussed earlier, the impact on employment and poverty was less than expected, and the Bank did not conduct sufficient analysis to inform its policy advice and lending on this issue.

Less than satisfactory outcomes were explained by inappropriate macroeconomic conditions (notably currency overvaluation or instability) or incomplete trade reform. In addition, the Bank needs to ensure adequate analysis of the distributional consequences of trade reform, complementary policies (regulatory reforms, infrastructure requirements, and skills needs), and external factors (such as the lack of knowledge by governments and entrepreneurs of global value chain links for the country's existing and potential exports, and market access restrictions). Weaknesses in these areas contributed to the inability of some countries to take advantage of the opportunities offered by trade reforms.