

Market Access and the World's Poor

With the conclusion of the Uruguay Round and a wave of unilateral reforms, barriers to trade have fallen substantially around the globe, spurring the growth of world trade. Developing countries as a whole gained significant market share—about 7 percent—in world nonenergy merchandise trade, thanks mainly to ambitious domestic policy reforms in the 1990s.

Global protection hits the poor hardest

However, progress in lowering barriers has lagged in two of the sectors with both the highest protection and with the greatest impact on poverty—agriculture and labor-intensive manufactures (such as textiles and clothing). Agriculture and other labor-intensive products matter to the world's poor because they represent more than half of low-income countries' exports, and about 70 percent of least-developed countries' export revenues.

Developing countries themselves are part of the problem. Although South-South trade is a much smaller share of total trade, average tariffs in manufactures are three times higher for trade among developing countries than for exports to high-income countries. Taken together and because of high protection for labor-intensive products around the globe, the world's poor face tariffs that are, on average, roughly twice as high as those imposed on the nonpoor.

Protection that affects the poor takes several forms, including tariff peaks, quotas for textiles and clothing, tariff escalation, and agricultural subsidies in high-income countries. In textiles

and clothing, the opening of markets has been slow, because the implementation of the World Trade Organization (WTO) agreement allows importers the leeway to select the products to be freed of quota restrictions. Thus despite progress made by the agreement, foregone export earnings for developing countries are sizeable. And due to still-high tariffs, market access will remain restricted even after the quotas have been abolished in 2005.

A “development round” would help—

These issues provide fertile areas where reciprocal negotiations in a “development round” could provide substantial benefits for development. Open trade in agriculture and labor-intensive manufactures would raise incomes among the world's poor.

—but effectiveness requires cooperative policies to complement negotiations

Global cooperation beyond negotiations could also expand trade. For example, most preferential access schemes to high-income countries' markets only partly breach the walls of protection. Their limited coverage and various other impediments to trade undermine their otherwise positive effects. The recent European Union's “Everything But Arms” initiative mitigates these problems by removing barriers on exports from least-developed countries. Extension of this initiative to the United States, Japan, Canada, and other higher-income countries would greatly stimulate the exports and growth of the least-developed countries.

Beyond these, “aid for trade” can help countries take advantage of new market openings. Providing assistance for countries to implementing WTO-sponsored reforms, designing programs that protect the poor during reform, and upgrading work skills will help ensure that trade benefits the poor. Moreover, domestic reforms and assistance to improve backbone services—such as transport, finance, and communications—can better link the poor to the global marketplace.

A changing landscape of merchandise trade

The 1990s witnessed a boom in world trade, with an average annual increase of 6.3 percent in the volume of global merchandise trade (1990–99)—outpacing global gross domestic product (GDP) growth by an average 4.2 percent per year over the same time period. Exports grew faster than output in every major region.

Developing countries gained market share in world merchandise trade—

The share of developing countries in global export markets rose by almost 7 percentage points, to about 25 percent of world non-energy merchandise trade, primarily on the strength of superior performance in manufacturing (figure 2.1). However the details behind these headlines reveal divergent trends—with some sectors and some countries enjoying exceptional growth, while others remained almost stagnant.

—but poor countries remained on the sidelines, dependent on slow growing commodities and labor intensive manufactures

Developing countries as a whole improved their penetration of world markets, but the export share of the 49 least-developed countries (LDCs) shrank from 3 percent in the 1950s to around 0.5 percent in the early 1980s, and has hovered around this very low rate over the last two decades (UNCTAD 2001). The least-

developed countries continue to be dependent on agriculture and labor-intensive manufactures, which together account for about 70 percent of LDC exports.

The expansion of trade volumes in these sectors did not keep pace with world trade growth, which has undermined the growth prospects of the LDCs and hindered the battle to reduce poverty. South-South trade represents about 30 percent of low-income countries’ nonenergy merchandise exports, and is more important than for middle-income countries. Exports of low-income countries to other developing countries increased rapidly, especially in agriculture. In labor-intensive manufactures, South-South trade is far more important in textiles than it is in clothing, footwear, and leather, both for low-income and for middle-income countries.

Moreover across products, the increase in developing countries’ exports was uneven. In labor-intensive manufactures, developing countries’ market share increased sharply and now surpasses that of high-income countries. By contrast, in agriculture, another labor-intensive sector, developing countries’ market share rose more modestly. This rise in market share was driven by South-South trade, with about one-third of all developing countries’ agricultural exports now directed to other developing countries—up from just about 20 percent in the early 1990s. The slow increase of developing countries’ share in world agricultural exports partly reflects developing countries’ export diversification out of agriculture, and partly reflects surplus production from high-income countries.

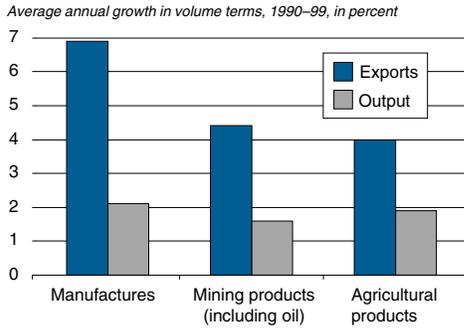
Exports of the poorest countries are even more concentrated in agriculture and labor-intensive manufactures. Sub-Saharan African agricultural products provide about 60 percent of export revenues, with little contribution from manufactures.¹

Labor-intensive exports can spur pro-poor growth

In developing countries—in particular the poorest where inexpensive labor is plentiful—

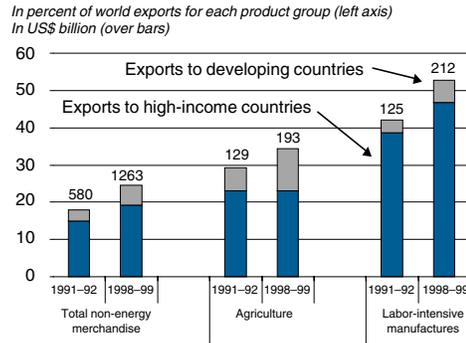
Figure 2.1 Changing global trade patterns

Export growth outpaced growth of output everywhere—



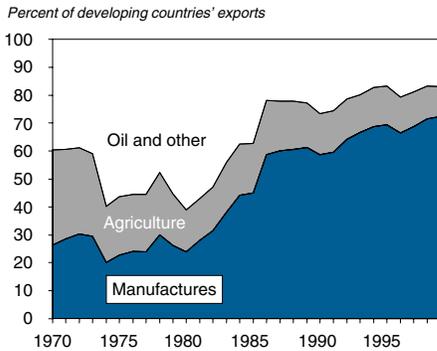
Source: World Bank staff calculations, based on WTO data.

—and developing countries increased their share in the global market



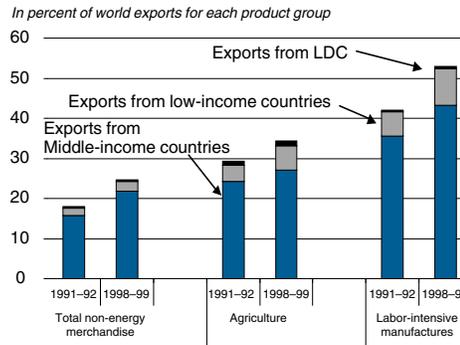
Source: World Bank staff calculations, based on U.N. Comtrade.

Manufactured exports have boomed—



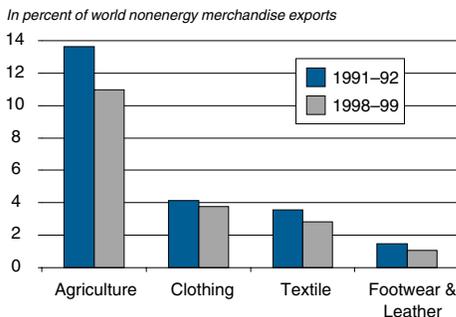
Source: World Bank staff calculations.

—but poor countries did less well



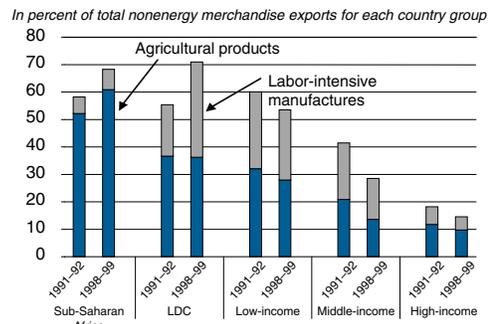
Source: World Bank staff calculations.

The shares of labor-intensive products in world exports declined—



Source: World Bank staff calculations, based on U.N. Comtrade.

—and poor countries remain dependent on these sectors



Source: World Bank staff calculations, based on U.N. Comtrade.

export-led growth can accelerate the reduction of poverty. Faster export growth can boost income growth of the poor, first, by stimulating overall economic growth. On average, every additional percentage point of growth in household consumption reduces the number of people living on less than \$1 a day by an estimated 2 percent (World Bank 2000a). And among all developing countries, successful integrating countries—the top third of developing countries ranked by an increase in trade-GDP ratios—grew faster (Dollar forthcoming). During each of the past two decades, the developing countries that have had fast export growth—leading to an increase in the share of nonenergy merchandise exports in GDP—have also had, on average, 1 percent higher real GDP growth (figure 2.2).

But if growth is necessary to reduce poverty, the pattern of growth also matters. Export-led growth can reduce poverty more directly when it fosters employment in labor-intensive sectors

where the poor have a stake. Capital-intensive and import-substituting growth has generally not been effective in alleviating poverty; agricultural growth, where there is a low concentration of land ownership and labor-intensive technologies are used, has almost always helped to alleviate poverty (Gaiha 1993; Datt and Ravallion 1998). Exports of textiles and clothing have also spurred labor-intensive growth in manufacturing, contributing to the reduction of urban poverty, especially among women.

—Agricultural exports can reduce rural poverty

Rural poverty accounts for nearly 63 percent of poverty worldwide, reaching 90 percent in China and Bangladesh, and between 65 and 90 percent in Sub-Saharan Africa (Khan 2000). Developing countries that have had more rapid agricultural export growth have also tended to have more rapid growth of agricultural GDP (figure 2.3). Thus increased agricultural exports contribute to increased agricultural income growth and reduced rural poverty.

The effects of trade growth on poverty would be muted if exports expanded *at the expense* of domestic food production. But in most cases, increased exports of nonfood agricultural commodities (such as coffee, cocoa, or cotton) provided hard currency to purchase inputs for food crop production, which boosts overall agricultural growth. In Vietnam, for example, nonfood crop production and U.S. dollar exports (primarily coffee) rose by about 15 percent per year from 1990 to 1998, following economic reforms. This boosted fertilizer use and contributed to a nearly 50 percent rise in food crop production over the same period. Agricultural GDP grew by 4.6 percent per year, and rural poverty fell to 45 percent in 1998—down from 66 percent in 1993 (World Bank 2000b).

In Uganda, nonfood crop production surged following marketing liberalization in the early 1990s. This surge was followed by a tripling of fertilizer use and a rise in food crop production. Thus, increased exports (primarily coffee) boosted agricultural GDP growth

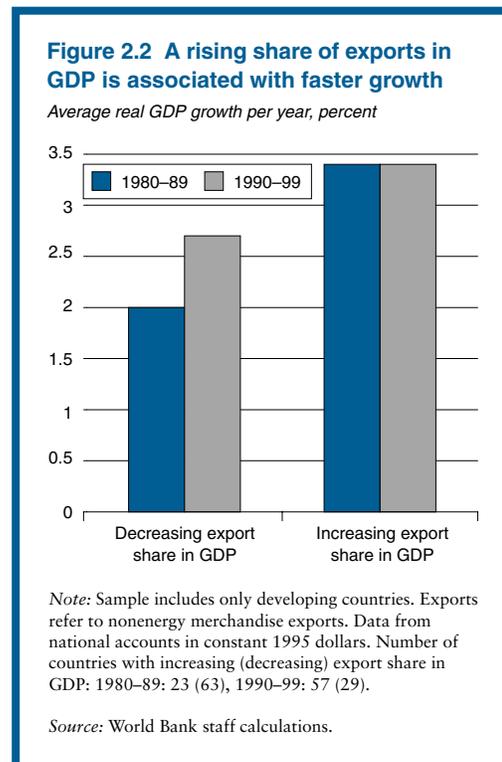
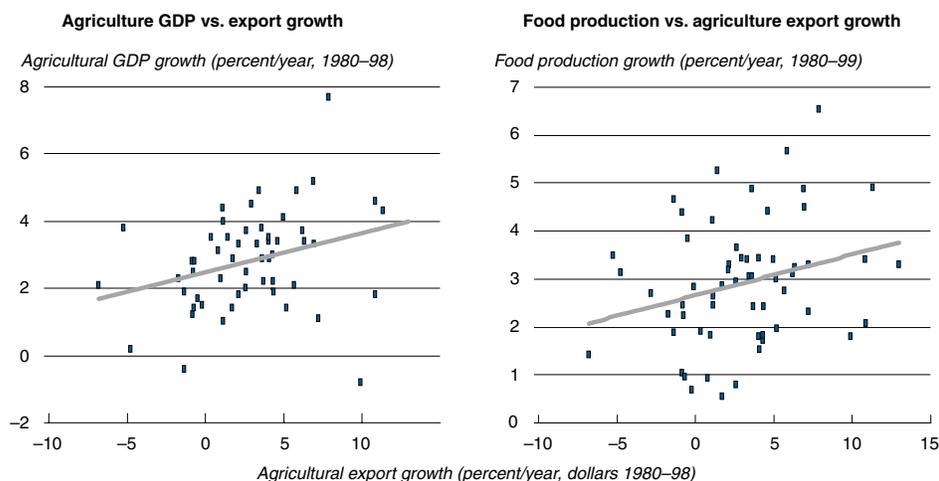


Figure 2.3 Increases in exports and agricultural production go hand-in-hand

Source: World Bank staff calculations, based on FAO data.

to about 4.4 percent per year, and eventually contributed to increased exports of other crops, creating a virtuous circle in agriculture. Rural poverty fell from 60 percent in 1992 to 39 percent in 2000, and among the poorest quintile of population primary school enrollment rose from 51 percent to 69 percent in the same period (World Bank 2001a).

Cross-country comparisons confirm that increases in agricultural exports rarely occur at the expense of food crop production. Rather than competing for scarce resources, the two are positively correlated at the national level (figure 2.3). Thus increased agricultural exports and increased food production are a win-win combination for developing countries.

Exports of textiles and clothing tend to reduce urban poverty—

Many developing countries have become major exporters of textiles and clothing (T&C), but others, especially in Sub-Saharan Africa, have yet to take advantage of this card. Low-cost labor and a competitive exchange rate are two important enablers of T&C exports. Institu-

tional arrangements that give duty-free and efficient access to inputs and foreign investors are no less important. Most success stories among developing countries confirm that booming exports of textiles and clothing fostered broad output growth (table 2.1).

Increased T&C exports are associated with growth of local manufacturing, through demand linkages and increased purchasing power among workers. In all successful textile exporters the share of private investment in GDP considerably increased during export booms. However, to benefit from backward linkages, the domestic suppliers of the T&C industry must be competitive and responsive.² For example, Pakistan seems to be a case of low industrial linkages and spillovers, as the increase in the share of manufacturing value added in GDP was just about the same as that of the T&C industry. Pakistan remained focused on protective policies to boost the cotton-processing sector on the back of abundant domestic cotton production (including, for example, export controls on cotton), rather than relying on globally integrated production

Table 2.1 Major export booms in textiles and clothing and effects on economic performance and poverty

Period	Bangladesh ¹		Madagascar		Mauritius		Pakistan		Tunisia	
	1975–80	1980–95	1992–95	1996–99	1980–85	1986–92	1980–85	1986–90	1980–86	1987–93
Share of T&C in exports (%)	0.2	39.3	7.7	19.1	27.7	47.8	36.5	53.7	19.3	34.7
Real GDP growth per year (%)	3.3	4.7	1.2	3.6	2.2	7.4	7.4	6.0	3.9	4.3
Share of manufacturing value added in GDP (%)	16	16.4	14.3	15.0	16.9	23.9	15.6	16.9	13.5	16.6
Poverty rate ²	Total Head Count		—		—		—		—	
	58.5	53.1	60.2	—	19.5	10.6	49.6	33.9	19.9	14.1
	Urban Head Count		—		—		—		—	
	50.2	35.0	—	—	—	—	38.2	28.0	12.0	8.9

Note: ¹Exports of clothing. ²According to the national definition—end of period. For each country, the second column, indicates T&C export booms.

Source: World Bank staff calculations.

using best-available materials. By contrast, in Mauritius and Tunisia, T&C export growth was accompanied by broad manufacturing growth.

Growth in textiles and clothing also bolsters employment and real wages. In Mauritius, growing T&C exports had a tremendous impact on unemployment, which was at 14 percent before the export boom and was virtually absorbed by 1992. Eventually the shortage of labor became a constraint on the expansion of output, bringing about a nearly 50 percent wage increase. Part of Mauritius' T&C production moved thus to Madagascar.

Because of faster employment and wage growth for low-skilled workers in all countries with T&C export booms, poverty declined significantly (table 2.1). As T&C manufacturing is typically concentrated in urban areas, urban poverty was more drastically reduced. In Bangladesh, one of the poorest countries with overwhelming rural population, total poverty declined slowly; however during the export boom in clothing, urban poverty dropped by almost one-third (World Bank 1999b). Thus to effectively contribute to the reduction of poverty, trade liberalization in agriculture and labor-intensive manufactures must go hand in hand.

—but trade liberalization affects the poor in various ways

Domestic trade policy reform lays the groundwork for better use of productive resources to

improve export performance. Poor workers and farmers will benefit from domestic trade policy reform, thanks to faster export growth, increased demand for their labor, and higher wages and producer prices. But trade liberalization can also affect the poor in the short term in complex ways that depend on country circumstances (see Winters 2000). These effects are difficult to track because trade policy reform is often undertaken in tandem with other major reforms that may also affect the poor—such as labor market reform, product market deregulation, or public enterprise reform.

Trade policy does have important short-term effects on the poor through three channels. Trade policy reform will, first, affect the poor by changing the prices of their consumption basket. Trade liberalization will shift relative prices, eventually increasing the prices of traded relative to nontraded goods and reducing the prices of imported relative to locally produced goods.

The overall impact on the poor through the price channel depends both on the composition of their consumption and on other reforms that may concurrently affect prices (such as the phasing out of subsidies and price controls). On balance, in net food exporting countries, while poor farmers may gain from higher producer prices, poor urban dwellers may suffer from higher food prices. In Ghana for example, while the rural sector gained from the reform and overall poverty was substantially reduced, living standards in Accra deteriorated in

1988–92. By contrast, in net food importing countries, poor consumers may benefit from lower domestic prices of imported food. Experience from Haiti illustrates the complex impact of trade liberalization on the poor (box 2.1).

Second, wages and employment may not always change as expected, depending on the pre-reform structure of protection. If for example, the protected sectors employ many of the poor, they may suffer in the transition to an open trade regime. This is more likely in middle-income countries, where sectors intensive in unskilled labor are often protected as they face stiff competition from low-cost producers (Davis 1996; Wood 1997). For example, in Mexico, a country that implemented an ambitious trade policy reform program from 1985 to 1988, the nominal tariff and import license coverage in apparel and footwear was among the highest in manufacturing (Revenga

1995). A similar pre-reform pattern of protection was also found in Morocco (Currie and Harrison 1997). A more common pattern is that the politically connected sectors that receive the most protection are the ones employing workers with higher wages.

A third channel is through the effects of government taxing and spending. Institutional disruptions can mitigate the benefits of trade liberalization for the poor. The abolition of the marketing boards for export crops sometimes led to abandoning key services that they often provided—such as research, quality monitoring, maintenance of rural roads, and credit to small farmers (Winters 2000; World Bank 2000a). In Zambia, for example, the abolition of the marketing board led to abandoning the purchase of maize in remote areas. There is also concern that, in the absence of reforms to broaden the tax base, reduced government rev-

Box 2.1 The aftermath of trade liberalization in agriculture: lessons from Haiti

The bold steps to liberalize trade in Haiti beginning in 1986 that continued throughout the 1990s have not produced rising incomes or reductions in poverty. Today with per capita income of less than \$500 and about two-thirds of the people living in rural areas, and more than 80 percent of the rural population living below the poverty line, Haiti remains the poorest country in the Western Hemisphere.

Prior to trade liberalization, the agricultural sector of Haiti was highly protected through tariffs (40 to 50 percent) and subject to many nontariff barriers and import prohibitions. Reforms brought down tariffs on rice, an important food staple, to 3 percent. The real price of rice to consumers was reduced by 50 percent and imports of rice jumped from zero to about half of domestic demand. Domestic rice production also fell—by more than 40 percent compared with the 1985–90 levels.

Does this mean that the poor suffered from the trade reform as some have contended (Oxfam International 2001)? Not necessarily. To be sure, some

poor, small farmers were forced out of rice production. On the other hand, many urban and rural poor were better off, because most of Haiti's poor were not producers of rice, but rather consumers who had been paying a high tax on a very basic food staple, curtailing their rice consumption. When rice became more affordable, national consumption doubled, and most of the poor were better off.

Yet this is only part of a story that does not have a happy ending. Severe governance problems eroded macroeconomic stability, discouraged investment, and undermined the capacity of the government to provide meaningful assistance for the poor, much less build infrastructure and institutions to support and sustain trade capacity. The eventual virtual collapse of the state has left Haiti mired in poverty. This underscores the lesson that trade policy cannot substitute for good governance and a pro-poor development strategy.

Source: Oxfam International 2001; IMF Staff Reports for the 1999 and 2000 Article IV Consultations; World Bank staff.

enues from trade-related taxes may trigger a decrease in social expenditures targeted for the poor. For example, Tanzania trade policy reform in the mid-1980s shifted income toward the largely untaxed small farmers, small enterprises, and the informal sector, thus reducing the domestic tax ratio (Kanaan 2000).

In sum the evidence is clearer on the long-term consequences for the poor: on average, in countries where outward orientation has increased, income growth of the poor has kept pace with mean income growth (figure 2.4).³ And on average, globalizers have grown faster, thus witnessing accelerated reduction of poverty. By contrast, countries where outward orientation has decreased have seen slower growth, and the poor in those countries have also fallen behind. Nonetheless the transition to these higher growth rates can take time and reform can impose short-term costs on the poor in some countries. Hence, governments have to design trade reforms carefully, provide

adequate social protection, and ensure maximum access to retraining opportunities.

Market access barriers limit export opportunities of developing countries

The Uruguay round of trade negotiations made a significant contribution toward lowering global barriers to merchandise trade on two fronts: improving market access, thanks to the reduction of tariffs and quantitative restrictions on a number of products; and extending multilateral disciplines to previously excluded sectors—particularly agriculture, textiles, and clothing. As a result of multilateral trade negotiations and unilateral reforms, average tariff rates have been halved—although they still remain high in South Asia and in the Middle East and North Africa (figure 2.5).⁴ Progress in lowering tariff barriers has been particularly important for more skill-intensive manufactures, on which an increasing number of developing countries in East Asia, Eastern Europe and Central Asia, and Latin America rely for exports. For example, the largely duty-free trade in information technology products that came into force with the “Information Technology Agreement” of the Uruguay Round strongly boosted South-North trade in the information and communications technology sector.

Tariff walls are high, especially in labor-intensive products

However despite progress, labor-intensive products still remain extensively protected. Tariff protection for agricultural commodities is higher than for manufactures, both in industrial and in developing countries. But in high-income countries the average tariff rate on agriculture is almost double the tariff for manufactures. Applied tariffs on labor-intensive manufactures also largely surpass the average for industrial goods. Compared to industrial products as a whole, labor-intensive manufactures are again more protected in high-income than in developing countries, by an estimated one-third.

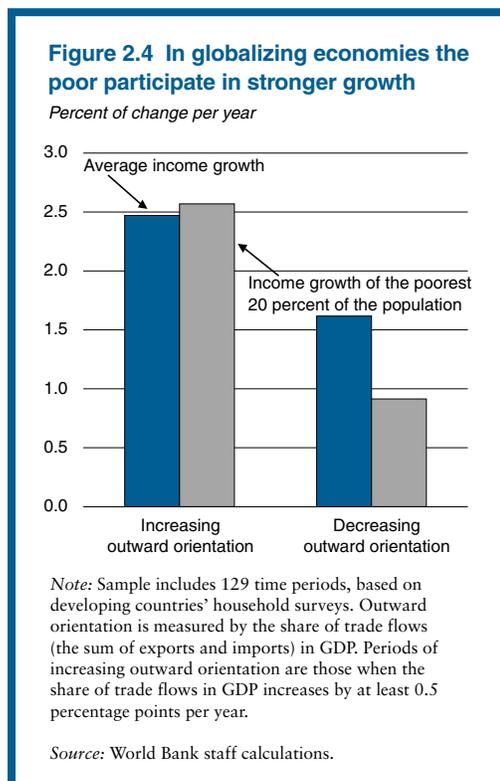
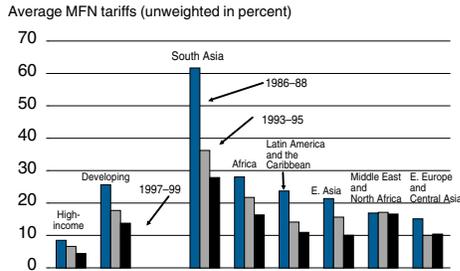


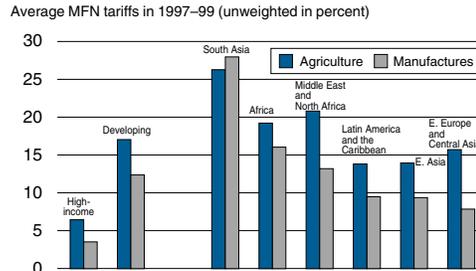
Figure 2.5 Tariffs still impede trade

In a decade, average tariffs have been almost halved—



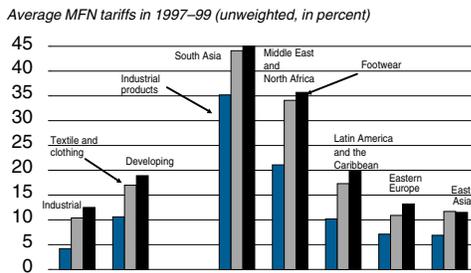
Source: World Bank, based on WTO data.

—but tariff protection in agriculture is higher than in manufactures.



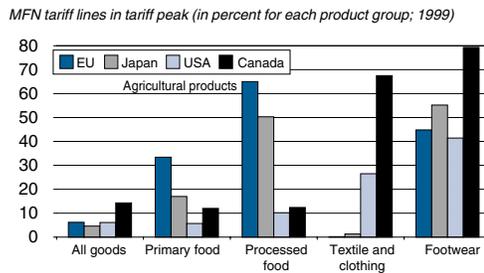
Source: World Bank.

Labor-intensive manufacturers are also sheltered—



Source: World Bank staff estimates, based on WTO data.

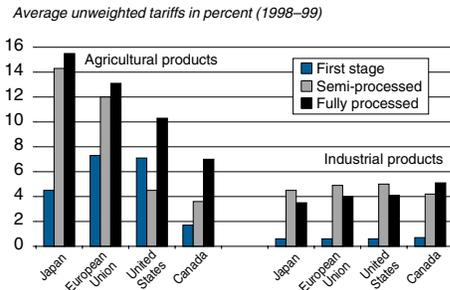
—as widespread tariff peaks shelter agriculture and labor-intensive manufactures in the Quad



Note: Tariff peaks are defined as tariffs greater than 15 percent.

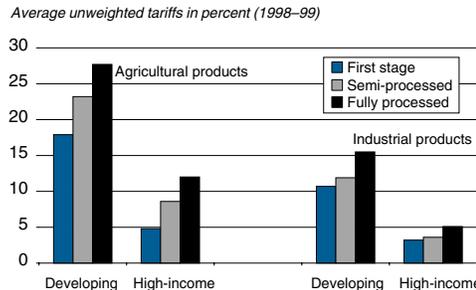
Source: World Bank, based on OECD tariff files.

Tariffs escalate steeply in the Quad—especially in agriculture—



Source: World Bank, based on WTO data.

—but tariff escalation is also common in developing countries



Source: World Bank, based on WTO data.

Trade barriers on labor-intensive products are commonly raised through tariff peaks (tariffs exceeding 15 percent) on imports of “sensitive commodities.” Imports at tariff peaks represent about 5 percent of total Quad (Canada, European Union (EU), Japan, and United States) imports from developing countries, and more than 11 percent of total Quad imports from LDCs (Hoekman, Ng, and Olarreaga 2001).

Within the Quad, tariff peaks are widespread but their pattern differs (figure 2.5). In North America, tariff peaks are commonly found in industrial goods, particularly on imports of textiles and clothing. By contrast, tariff peaks in the EU and Japan are common in agriculture—especially on imports of processed food, and tariff peaks on imports of footwear are widespread across all Quad markets and surpass those found in textile and clothing. In developing countries, tariff peaks are prevalent also, because applied tariffs are close to the tariff peak threshold.

Tariff escalation is a major concern for developing countries

Tariffs often rise significantly with the level of processing (tariff escalation) in many high-income and developing countries. Tariff escalation in high-income countries has the potential of reducing demand for processed imports from developing countries, hampering diversification into higher-value added exports (Blackhurst, Enders, and Francois 1996).

In high-income countries, tariffs escalate steeply, especially on agricultural products (figure 2.5). In the Quad, tariffs on more processed agricultural commodities are comparatively higher in the EU and Japan, while in the United States there is evidence of reverse escalation between unprocessed and semiprocessed commodities. Though less prevalent, tariff escalation also affects imports of industrial products—especially at the semiprocessed stage. Examples of such products, in which many developing countries have a comparative advantage, include textiles and clothing; leather and leather products; wood, paper, and pulp; furniture; rubber products; and metals.

In developing countries, too, the average tariff for fully processed agricultural products and manufactures is higher than on unprocessed products. The reduction of tariff peaks in the Quad and other countries would mitigate tariff escalation. In the EU and Japan, for example, tariff peaks are more widespread on imports of processed food than on primary food imports (figure 2.5). Trade of products where more processed exports from LDCs have a chance of breaking through would thus receive a boost.

Despite progress, trade in agriculture remains heavily distorted

The Uruguay Round Agreement on Agriculture (URAA), which came into force in 1995, marked an important step in improving access to sheltered agricultural markets in high-income countries. A wide range of nontariff barriers was abolished, including quantitative import restrictions, variable import levies, and discretionary import licensing. These barriers were converted to ordinary tariffs (tariffication). Existing and new tariffs were bound, and these bindings were subject to reduction. Developing countries were allowed more compliance flexibility through longer implementation periods and lower reduction commitments.

Because international agricultural prices in the base period for the URAA (1986–88) were way below high domestic prices supported by quotas, the conversion of quotas into tariff equivalents resulted in high rates of tariff protection (OECD 2001a; World Bank forthcoming). Moreover tariff reduction commitments involved a simple average across products, creating much leeway to spread reductions unevenly, with lower cuts in more sensitive commodities. Hence scheduled tariff reductions over the URAA implementation period may not have reduced protection enough to significantly improve market access and boost agricultural trade (Diakosavvas 2001).

Tariff peaks in agriculture occur frequently on processed products and temperate commodities. They are less common on unprocessed fruits and vegetables and tropical commodities, which are not produced in high-income countries but

are major export crops of least-developed countries. Thus tariff peaks could be seen as not targeting developing countries in particular, since such tariff peaks can be found where market shares of developing countries in Quad imports are comparatively low. However, many developing countries in temperate zones have the potential of competing as lower-cost producers in temperate commodities. Hence besides providing sizeable market price support to high-income countries' producers, developing countries' exporters may be displaced by high tariff peaks, especially in the EU where intra-EU trade is duty-free. Indeed, intra-EU trade in product groups with a high share of tariff-peak lines is prevalent, at about 70 percent of EU countries' agricultural imports. By contrast, when tariff peaks are less widespread, non-EU suppliers seem to have more opportunities.

Concerns about market access also arise from the poor performance of tariff quotas (TRQs) introduced by the URAA with the aim of securing a minimum level of market access.⁵ The average fill rates of TRQs have been low and declining, from 67 percent in 1995 to 63 percent in 1998, while about a quarter of tariff quotas were filled to less than 20 percent. Evidence as to whether the method of administration of tariff-quota allocations may have an influence on the fill rates is still unclear (WTO 2001; OECD 2001a). But the low fill rate could reflect high "in-quota" rates; in some Quad markets in-quota rates are *above* the average for agriculture (OECD 1999a). And, for specific products, over-quota rates skyrocket—such as the EU 130 percent tariff for above-quota bananas.

Support to agriculture is sizable and growing

At an estimated \$245 billion in 2000—about five times the level of international development assistance—support to agricultural producers in high-income countries remains sizeable (OECD 2001b). Total support to agriculture (as defined by the OECD) is even higher, at about \$327 billion in 2000—or 1.3 percent of OECD countries' GDP.⁶

Support is often rationalized on the non-economic benefits of agriculture, which are not properly valued by the market—such as environmental protection, food security, and maintenance of rural communities (Winters 1990; Maier and Shobavashi 2001). But extensive support may be counterproductive for these goals because subsidies, in addition to accounting for the "multifunctionality" of agriculture, have a number of side effects. For example, production-linked subsidies encourage environmentally unsustainable farming practices, boosting the use of chemicals, fertilizer, and fuel in order to produce additional output beyond what competitive conditions would dictate. Agriculture now thus contributes about *one-fifth* of global greenhouse gases—50 percent of methane and 70 percent of nitrous oxide—while high-income countries account for the major share of global agricultural greenhouse gas emissions (OECD 1999b).⁷ Enhancing the environmental performance of agriculture remains a challenge, but efforts should rely on appropriate incentive policies, tailored to local environmental circumstances and demands (OECD 2001d).

Production-related support in high-income countries also distorts agricultural commodity trade and affects developing countries. It boosts production of agricultural commodities and reduces agricultural imports, thus displacing developing-country exports in high-income countries' markets. The case of the U.S. subsidies to sugar producers illustrates both the pernicious impact of support on developing countries' exporters, and the large costs borne by high-income countries' consumers and taxpayers (box 2.2).

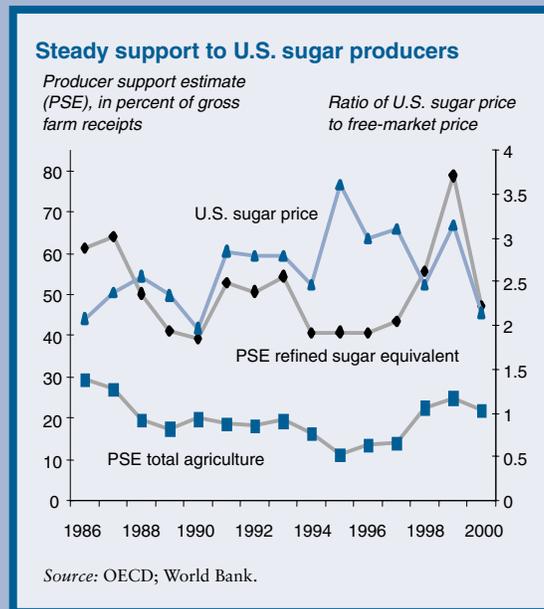
The unwanted production surpluses are dumped into world markets with the aid of export subsidies, depressing prices for many temperate agricultural commodities (Burfisher 2001). The case of growing EU exportable surpluses of wheat illustrates the potential distortions to trade (box 2.3). The incidence is generally negative for agricultural exporters—especially developing countries that export temperate commodities or have the capacity of

Box 2.2 U.S. sugar policy and its impact on imports

The United States began to directly intervene to support agricultural commodity prices in 1933 with the introduction of the Agricultural Adjustment Act. The Act has been modified many times, but is still the basis of most of the U.S. agricultural policy. Sugar is one of the most protected commodities under U.S. policy (see figure).

The United States is the world's largest consumer of sweeteners, with the equivalent of 142 pounds of raw sugar consumed per person per year. The U.S. sugar industry is heavily subsidized, with about half of sugar producers' revenues coming from government support. U.S. sugar producers have been protected from lower world market prices since the early 1980s, by successive farm legislations that provided price supports through restrictive import controls. On average, U.S. sugar producers have received 2.6 times the world market price for sugar since the mid-1980s (see figure).

Apart from protecting sugar production, domestic support to sugar also provides higher than world market prices to corn syrup producers. This has encouraged the development of an important High Fructose Corn Sweetener (HFCS) industry that now supplies half of the country's sweetener consumption, especially in products such as soft drinks. HFCS production is now four times higher than in 1980, and surpasses sugar production, which has increased by about 50 percent (according to the U.S. Department of Agriculture). Sugar imports by the United States



fell by one-half over the period, from 4.3 million tons in 1980 to slightly less than 2 million tons in 1998. The sugar policy costs foreign sugar producers an estimated \$1.5 billion in lost sales.

Source: World Bank staff, based on Sheales and others 1999.

becoming low-cost exporters. There are also, however, benefits for net food-importing developing countries from lower import prices for food (Freeman and others 2000).

The URAA also covered trade-distorting measures of support and export subsidies (box 2.4). The value of support subject to reduction commitments in OECD countries declined significantly, to about 65 percent of its level in the base period. However during the implementation period, this was largely offset by increased support under measures exempt from reduction commitments, so that in 1997 overall support was practically unchanged from its

base-period level.⁸ Subsidies that were exempt from reduction commitments now account for about 60 percent of total OECD-country agricultural support, even though some of these subsidies may affect production and trade (OECD 2001a).

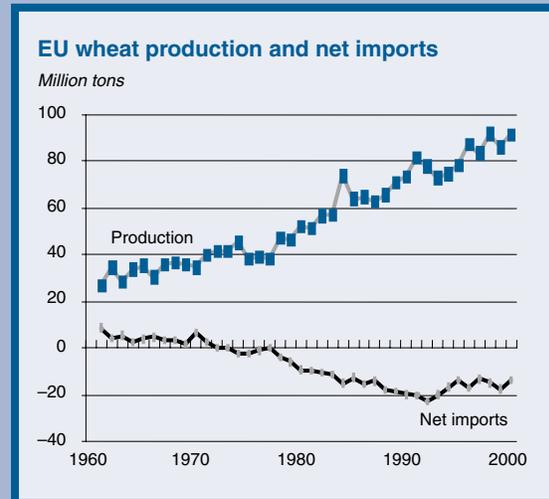
The overall level of support to producers—as measured by the OECD's producer support estimates (PSE)—has further increased since 1998, in response to the decline in world commodity prices, and now represents about 35 percent of gross farm receipts (figure 2.6).⁹ And because support is counter-cyclical, it insulates farmers in high-income countries from changes in world

Box 2.3 Wheat production with CAP support

Agriculture was given a central role when the original European Economic Community (EEC) established the Common Agricultural Policy (CAP) in 1957. The basic market support set out in the Treaty of Rome remains much the same today, despite successive reforms to the CAP since the early 1990s. The CAP was very successful at achieving its goals of food self-sufficiency and stable producer prices. In fact, it was so successful that it encouraged farmers to produce more than was needed, which caused intervention stocks to build and commodities to be exported using export refunds. Wheat production is a case in point.

The first nine countries to join the EEC account for nearly 90 percent of EU wheat production. These countries have adjusted to the high and stable wheat prices established by the CAP, and they have responded by increasing yields by 2.5 percent per year since 1970, compared to only 1 percent per year for the United States, the world's largest wheat exporter. Domestic support for wheat (as measured by the OECD's producer support estimates) remains sizeable in the EU despite several reforms to the CAP. From 52 percent of gross farm receipts on average in 1986–88, it declined only marginally to an estimated 48 percent in 1998–2000.

The impact of high wheat prices was not only to increase production, but also to reduce demand and further contribute to the surpluses. Net exports of wheat surged to 22.8 million tons in 1992, and then declined somewhat due to CAP reform measures during the 1990s (see figure). One of the consequences



of the CAP was that lower cost producers were deprived of a market for their products. Argentina for example, is a low cost producer that could supply wheat to the EU. With more than 50 percent of its exports concentrated on agricultural products and agro-processing manufactures, Argentina in particular may be suffering from trade distorting subsidies (see Nogues 2000).

Source: World Bank staff.

prices and makes production less responsive to swings in demand. As a result, world commodity prices become more volatile, and during downturns the burden of adjustment is shifted disproportionately to producers in developing countries who enjoy much lower levels of support (Tyers and Anderson 1992; Winters 1994).

Over the past 15 years support to agriculture in high-income countries has declined only marginally as a share of gross farm receipts. The outlook is unclear, because the reduction commitments are sectorwide, allowing governments much leeway to target the reductions, while in-

creasing support for specific “sensitive” commodities. Many commodities of export interest for developing countries remain heavily subsidized—such as, for example, rice and sugar, where support covers as much as 80 and 45 percent of gross farm receipts (OECD 2001b).

Export subsidies are particularly damaging

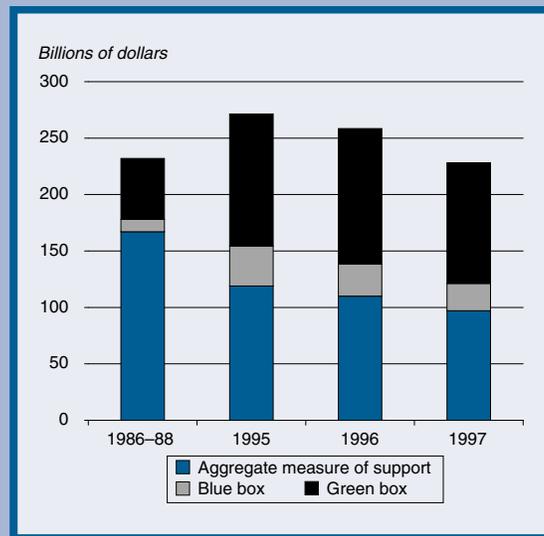
The effectiveness of URAA in disciplining export subsidies is also questionable. Because export subsidies in the 1986–88 base period were sizeable, the limited reduction commitments

Box 2.4 Bringing support to agriculture and export subsidies under multilateral rules: A long-awaited endeavor

A key objective of the URAA was to reduce trade-distorting support to agriculture, while creating room for government policies to design appropriate nondistorting support schemes, in response to country-specific circumstances. Three main categories of support were distinguished:

- a) Trade-distorting support (often referred to as “amber box” measures), such as market price-support through administered prices supported by restrictive trade measures and production-related subsidies (based on output or on the use of inputs).
- b) Support with no, or minimal, distorting effect on trade (often referred to as “green box” measures). These may include a vast array of programs, such as decoupled income support measures; payments covering services for research and development; pest and disease control; infrastructural services; domestic food aid; structural adjustment and regional assistance; and environmental programs.
- c) A category of direct payments under production-limiting programs—the so-called blue box measures—was also distinguished.

Reduction commitments were scheduled on trade-distorting support, expressed in terms of a “total aggregate measurement of support” (AMS). Under the URAA, developed countries are required to reduce total base-period AMS by 20 percent over a period of six years. Developing countries with AMS commitments are subject to a 13 percent reduction over 10 years. Measures in the “green box”—and also, under certain conditions, in the “blue box”—have been exempt from URAA reduction commitments.



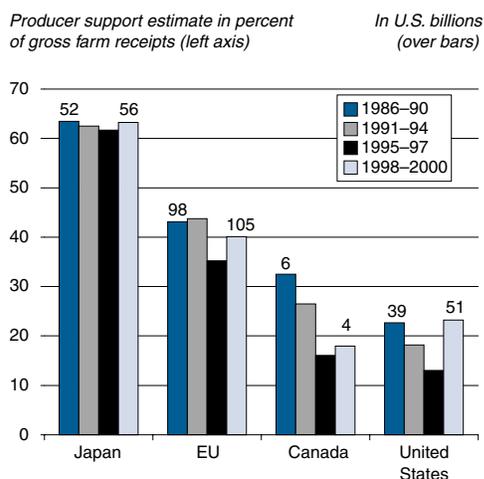
Export subsidies in agriculture allow countries to export production surpluses to the world market at prices below the high prices prevailing in their domestic markets. Export subsidies were about \$7 billion on average in 1995–98, of which 90 percent was granted by the EU. In the URAA high-income countries agreed to reduce base-period subsidized exports by 21 percent, in equal steps over six years—and to cut the corresponding budgetary outlays by 36 percent. Developing countries agreed to a 14 percent reduction in subsidized export volumes over a 10-year period.

Source: OECD 2001a; WTO 2001; World Bank forthcoming.

taken in the URAA leave broad margins for continued subsidization. Thus for a number of products, permitted subsidized exports during URAA implementation were larger than actual subsidized exports in the first half of the 1990s (OECD 2001a; World Bank forthcoming). And the share of subsidized exports has even in-

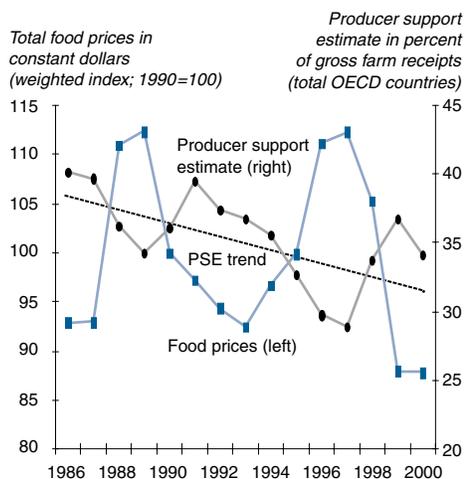
creased for many products of export interest to developing countries. For example, subsidized exports of wheat represented 25 percent of total wheat exports in 1998, up from 7 percent in 1995, while subsidized exports of sugar rose to 31 from 19 percent in the same period (Ingco and Winters 2001).

Figure 2.6 Support to agriculture in the Quad is growing ...



Source: OECD.

... partly due to the fall in commodity prices



Source: World Bank; OECD.

In the EU, the Agenda 2000 Common Agricultural Policy (CAP) reform marked a step in the right direction to reduce the need for export subsidies by cutting the support prices for cereals, beef, and dairy, but it is unlikely to be sufficient to eliminate the EU exportable surpluses in the years ahead. In addition to direct export subsidies, officially supported export credits have expanded during the 1998 Asian financial crisis, and are largely used in the United States. By resulting in targeted cost discounts for buyers, export credits might have similar distorting effects on trade as direct export subsidies. The URAA called for negotiation of export credit disciplines, which has not yet been achieved.

Due to remaining restrictions on textiles and clothing, developing countries forego sizeable export earnings

The Uruguay Round Agreement on Textiles and Clothing (ATC) provides for the gradual phaseout of the multifiber arrangement (MFA) country-specific quotas over a 10-year period, ending in 2005 (box 2.5). The ATC was an im-

portant step to improve developing countries' access to high-income countries' markets, because it became very difficult for the importers to introduce new quotas. Moreover, the ATC abolished voluntary export restraints in response to pressure from developing countries. These measures were identical in form with the MFA quotas.

However the effectiveness of ATC in freeing up markets has been limited by two main shortcomings. First, scheduled quota integration is "back-loaded," with quota-free market access for nearly half of all imports due only at the end of the transition. Hence the transition is unlikely to be smooth for currently shielded producers. This could disrupt the post-ATC regime by encouraging calls for higher tariff protection, or for more intensive use of contingent protection measures (box 2.6). And in textiles, after the Uruguay Round, the use of contingent protection measures has increased faster than in other sectors. In 1998-99, initiations of antidumping investigations in textiles represented 11 percent of total, up from only about 5 percent, on average, in 1990-92 (WTO 2001).

Box 2.5 A primer on the agreement on textiles and clothing

The Multifiber Arrangement (MFA) that entered into force in 1974 (like its predecessors the Short- and Long-term Cotton Arrangements between 1961 and 1973) established rules for the imposition of country-specific quotas, either through bilateral agreements or unilateral actions. This conflicted with the General Agreement on Tariffs and Trade (GATT) principle of nondiscrimination against trading partners. As of 1995, only the United States, EU, Canada, and Norway continued to use quotas to restrict their imports of textiles.

The return to GATT rules has two components: (1) a schedule for freeing textiles and clothing from import quotas (the “integration” component of the ATC); (2) additional provisions for accelerated growth of remaining non-integrated quotas (the so-called liberalization component of the ATC). Products remaining under restriction will be allowed an additional increase in quota growth rates—above the general 6 percent annual growth agreed under the MFA. Such products will have their quota increased

by an additional 16 percent in the first step, 25 percent in the second, and 27 percent in the third.

The ATC is being implemented in four steps. In the first step, which took effect on January 1, 1995, WTO members had to secure quota-free market access matching, at a minimum, 16 percent of the total volume of their 1990 imports. In the second step, which started on January 1, 1998, an additional 17 percent of total 1990 imports had to be integrated, followed by an additional 18 percent in the third step, which commences on January 1, 2002. Finally, on January 1, 2005, quota-free access corresponding to the remaining 49 percent of total 1990 imports must be secured.

The choice of products to be integrated is left to the importing country, but they must cover at least one item from each of four major product groups: yarns and tops, fabrics, made-ups, and clothing.

Source: Based on ICTB 1999.

Second, the ATC rules for the removal of quotas are framed in terms of overall import shares in textiles and clothing, rather than in terms of the number of quotas. This allows importing countries the leeway to select the products to be freed of quota restrictions in each step, which slows the pace of liberalization.¹⁰ Up to 2000, more than 33 percent of trade was integrated, fulfilling the minimum ATC requirements. But products that have been freed of quotas by the EU and the United States represent only small shares of their total textile and clothing imports—about 6 percent of 1995–97 imports for the United States and less than 5 percent for the EU (ICTB 1999). Moreover, the products of interest to developing countries that were integrated tend to have low value added—such as tops, yarns, and fabrics—with clothing representing only a small share of the total.

Due to the slow pace of the liberalization, potential benefits for developing countries are being eroded, and foregone export earnings are sizeable. For example, on current trends, the share of intra-EU trade in textiles and clothing could further decline from 49 to around 43 percent of total EU countries’ imports by the ATC expiration in 2005. Assuming a twice-as-fast decline under a more ambitious liberalization, this share could drop by an additional 7 percent. Thus foregone export earnings for restrained developing countries in the EU could be as high as \$10 billion a year. In the United States, after the creation of the North American Free Trade Agreement, restrained suppliers were displaced by booming textile and clothing exports from Mexico, which grew by about 35 percent per year. Despite these trade diversion effects, the sharp increase in Mexican exports illustrates the potential for other restrained low-

Box 2.6 Anti-dumping—and better alternatives

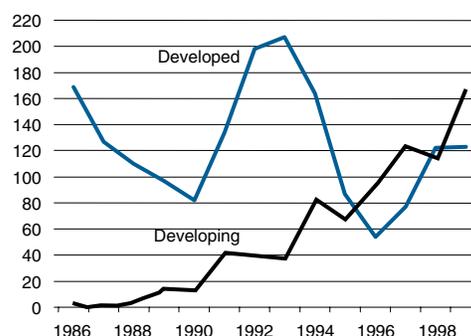
Import-competing firms are often tempted to resort to *antidumping laws*—which are permitted by WTO rules—to allege unfair trade practices by foreign competitors. A firm is said to be dumping if its export price is less than either the price in its home market or the average cost of production. Antidumping laws enable nations to impose offsetting duties on imports found to be both dumping products on the domestic market and causing “material injury” to a domestic industry. The main users of these laws were developed countries, but increasingly developing countries have taken recourse to these laws (see Figure). Industrial and developing nations are equally targeted by antidumping actions.

In addition, some nations take action against imports that they suspect may have been subsidized by another government. These so-called countervailing duty cases are also allowed under WTO rules and, if an investigation reveals that allegedly subsidized imports have injured a domestic industry, then a tariff can be placed on the products in question. Both antidumping laws and *countervailing duty* laws are referred to as “unfair trade laws,” reflecting the view that dumping and subsidization tilt the commercial playing field towards foreign firms. However, the more widespread resort to “unfair trade laws” is diluting the gains from trade liberalization.

Disrupting surges in imports can be far better handled through the use of *safeguard measures*. These afford domestic firms the chance to adjust to greater competition from abroad, but do so only for a fixed period of time. WTO rules allow members to impose temporary restrictions on imports that are

Developing countries are victims and players in the rising game of antidumping

Antidumping cases initiated by developed and developing countries, 1986–1998



causing serious injury to a domestic industry. Because the import protection is temporary, trading partners know that their market access has not been permanently reduced. By contrast, the antidumping and countervailing duty laws are often implemented in such a way that the tariffs once imposed they are almost never withdrawn. Worse still, if nations believe that the market access obtained during a trade negotiation are going to be permanently eroded by the use of the unfair trade laws, then they will be less inclined to start trade negotiations in the first place.

Source: World Bank staff.

cost producers to expand their exports, should market-access obstacles be removed.

Evaluating the impact of MFA quota abolition requires a model comprehensive enough to take into account the interplay between suppliers, as well as the sectoral interactions of each economy (see also chapter 6, and Kathuria and others (2001) for South Asia). Given the equally slow pace of liberalization in North America, a rough estimate of foregone export earnings for developing countries could

be twice the estimated amount in the EU—equivalent to about 12 percent of total developing countries’ textile and clothing exports.

Market access in textiles and clothing will remain restricted even after the MFA-related quotas have been abolished, because tariff barriers are high. While 90 percent of total high-income countries’ imports of manufactures face tariff rates below 10 percent, only about half of textile and clothing imports face such low tariffs. Moreover 28 percent of total OECD

countries' imports of textile and clothing still face tariff peaks, down only marginally from 35 percent in the pre-Uruguay Round regime (OECD 2001c).¹¹

Preferential market access for developing country exports

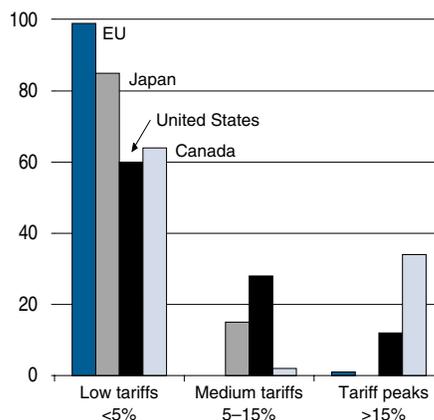
Preferential access schemes to high-income countries' markets, such as the generalized system of preference (GSP) and the LDC regimes, aim to partly mitigate the effects of high most-favored nation (MFN) tariffs on export products of developing countries. The United Nation's 48 least-developed countries benefit from LDC preferential access in all Quad countries, where 75 percent of their exports are sold.¹²

Even though on average, these preferential schemes look relatively generous (Hoekman and others 2001), a number of factors erode their effectiveness in reducing trade barriers faced by poor countries. First, preferences mainly apply to products that already face relatively low MFN tariffs (below 10 percent). The margins of preference on tariff peaks are significantly lower—with the exception of the EU, where the LDC preference margin for tariff peak products is about 70 percent. This margin is only 25 percent in Canada and 30 percent in Japan and the United States. Reflecting the selectivity of preferences and the structure of LDC exports, high tariffs are thus common in some Quad markets on products on which LDC beneficiaries reveal some comparative advantage (figure 2.7).

Second, tariff preferences under GSP and LDC regimes can also be easily eroded by non-tariff measures, such as antidumping, safeguards, rules of origin, and graduation mechanisms. The case of the safeguard measures applied by Japan on imports of Shiitake mushrooms from China illustrates this point (box 2.7). Finally, the GSP (and LDC regime implicitly) have graduation mechanisms that are related to income and market shares. They are time-bound and subject to (uncertain) renewal. Countries graduate if they pass a certain per capita income threshold and if they expand their exports of products beyond a certain im-

Figure 2.7 Despite preferences, LDC exports to the Quad often face high tariffs

In percent of LDC exports to each market (1996–99)



Source: World Bank staff calculations.

port share in the market of the GSP-granting country.

There is evidence that tariff preferences help the least-developed countries take advantage of better export opportunities in Quad markets. In the post-Uruguay Round period, LDC exports to the EU that receive high preferences, have grown by about 8 percent per year on average, outpacing growth of LDC exports that receive medium or low preferences (figure 2.8). A similar pattern is seen in Canada and Japan.¹³

On balance, global tariffs penalize developing countries—

The post-Uruguay Round tariff structure penalizes developing countries as a whole because their exports tend to be concentrated in products where market access is highly restricted. Trade-weighted applied tariffs convey a sense of tariff incidence across countries and product groups (figure 2.9).¹⁴ In *manufactures*, developing country exporters face, on average, higher trade-weighted tariffs than other suppliers, both in high-income and in developing countries' markets. Tariff walls faced by developing-

Box 2.7 Mushroom wars

Shiitake mushrooms are among the most popular mushrooms in Japan, where an estimated 30,000 farmers grow them. Japanese trading companies began in the early 1990s to encourage Chinese farmers to use Japanese spores and modern cultivation techniques to improve the quality of Chinese mushrooms to Japanese standards. The effort was a huge success. In the humid mountainous climate of Fujian province, as well as in Shandong, farmers quickly adapted and China became a global mushroom giant. The same techniques were applied to other mushrooms, and exports climbed to \$120 million per year. Farmers' incomes in Fujian and Shandong rose, and consumers in Japan seemed happy to get the shiitake mushrooms at one-third the price of domestically produced shiitakes.

But Japan's shiitake farmers feared for their jobs and sought protection from the government. The government responded. Japan at first threatened to

use inspection requirements as a veiled form of protection. But since April 17, 2001, imports over 8,000 tons face a tariff of 266 percent, while an amendment to the tariff code imposed temporary emergency import curbs. The import curbs will be implemented for up to 200 days through November 8. It is the first time Japan has invoked import curb measures under the WTO's ordinary safeguard mechanism designed to slow imports to allow a specific industry to adjust to heightened competition from foreign suppliers. The Chinese government urged Japanese officials to reconsider the action, to no avail. China has retaliated by imposing punitive duties on several Japanese exports. It is likely that the mushroom war is not over.

Source: The Economist, February 8, 2001; The Guardian, April 19, 2001; Peoples' Daily, April 17, 2001; Financial Times, June 20, 2001.

country exporters of manufactures in developing countries' markets are about three times higher than in high-income countries' markets.

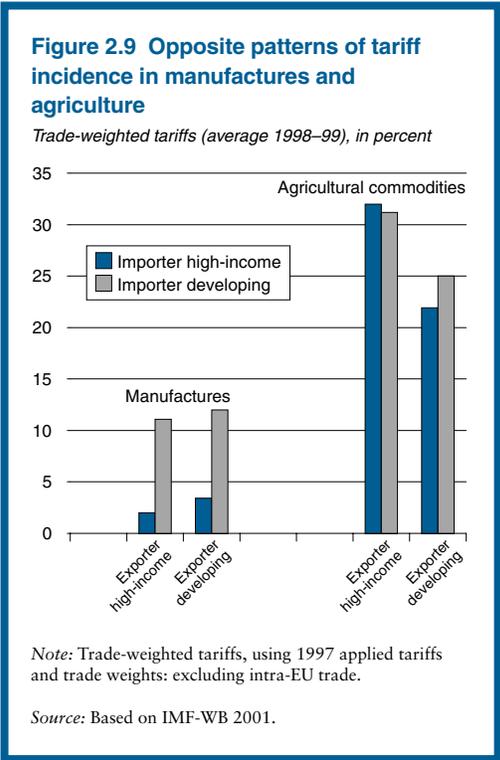
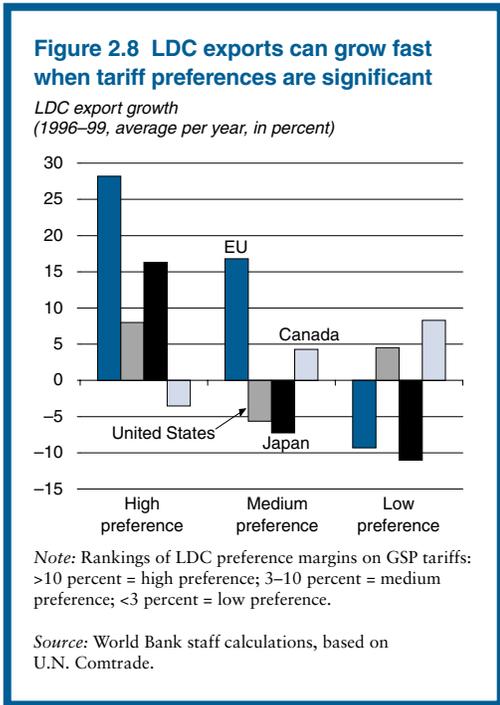
In *agriculture*, developing-country suppliers face lower trade-weighted tariffs than do other exporters, both in high-income and in developing countries' markets. This is because trade preferences to some extent mitigate the impact of tariff protection on developing countries, while a large share of developing countries' exports is in tropical commodities, for which tariff protection is relatively low. By contrast, high-income countries' agricultural exports are mainly concentrated in temperate agricultural commodities and dairy products, which face widespread tariff peaks.

Because average applied tariffs in agriculture are higher in developing countries, South-South trade of agricultural commodities faces higher trade-weighted tariffs than exports from the South to the North (South-North trade). With an increasing share of developing countries' manufactured and agricultural exports being directed toward other developing coun-

tries, high levels of tariff protection in the South may also impede prospects for export-led growth. Trade in agriculture may suffer more from high levels of protection in middle-income developing countries because markets in these countries are growing fast, reflecting fast population and income growth. High tariff protection in middle-income developing countries may also damage the export opportunities of low-income countries, especially in agriculture and in textiles where the export market shares of low-income countries have increased rapidly.

—and denies the world's poor access to the global markets

Because developing countries are home to the world's poor—56 percent of the world's population defined as those living on less than \$2 per day (World Bank 2000c)—high tariff barriers on developing countries' exports act as a roadblock to market access by the poor. Compared with the nonpoor of the world, poor people are more exposed to high penalties of the global system of protection.



The world’s poor generally earn their living in the rural sector and other labor-intensive activities—such as light manufacturing, informal services, and construction. When these products find their way to the world markets, they face high tariff barriers—such as those faced by agricultural commodities and labor-intensive manufactures. Labor services face particular restrictions—for example, restrictions on temporary cross-border movements of workers for the provision of construction services (see chapter 3).

One way to quantify the incidence of protection—albeit in rough fashion—is to look at effective tariffs faced by the different income groups in access to the world markets. Despite the existing preferential access schemes for developing countries’ exports, the world’s poor face tariffs that are more than twice as high as the nonpoor face (box 2.8). This fact is independent of their position in the relative scale of poverty. Making world merchandise trade work for the world’s poor would require bold steps to remove this disparity.

Liberalizing trade to promote development

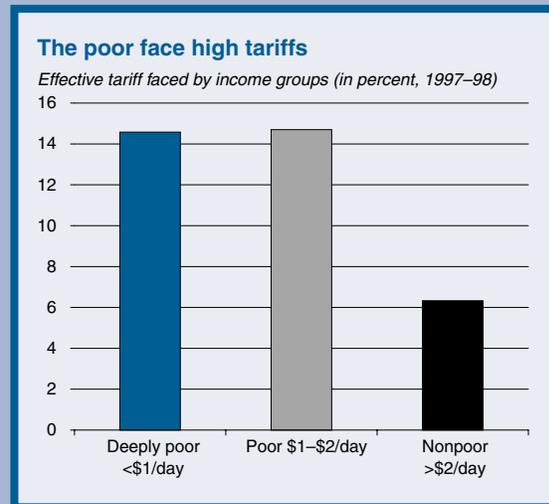
Removal of trade barriers on labor-intensive products will generate shared benefits, both for high-income and developing countries (these are quantified in chapter 6). Benefits for developing countries would include greater access to high-income countries’ agricultural and apparel markets and more buoyant demand in industrial countries as a result of lower prices to consumers. Middle-income countries that have access to international capital markets but still depend greatly on exports of protected products (for example, Argentina), could possibly see a decline in the risk premia they face, because more buoyant growth of export revenues could make their balance of payments less vulnerable to economic swings. With better access to global markets, domestic policy reforms become important to create export opportunities and absorb the dynamic gains from trade.

Box 2.8 Calculating effective tariffs faced by the poor

Effective tariffs faced by people in different income groups convey a sense of uneven access to the world markets (see figure). For people in each income group, effective tariffs are calculated on the basis of the trade-weighted tariffs faced by exports of their home countries. For simplicity, it is assumed that all poor can be found in labor-intensive merchandise production, while the nonpoor earn their living across the whole array of economic activities. Thus calculations of effective tariffs on those living on less than \$2 per day are based on trade-weighted tariffs faced by countries for exports of agricultural products and labor-intensive manufactures. Calculations of effective tariffs on the nonpoor are based on trade-weighted tariffs faced by countries across exports of all goods. Trade-weighted tariffs are calculated from using 1998 applied tariffs and trade weights.

Effective tariffs faced by each income group are calculated as the sum of trade-weighted tariffs faced by the exports of different countries, using as weights the share of each country's population in each income group (based on 1998 poverty data). Since by global standards even the relatively poor in all high-income countries have consumption greater than \$2 per day, the whole population of these countries is in the nonpoor group.

Due to their size, China and India are the two single countries that weigh more in these calculations. The trade-weighted tariff on exports of labor-intensive products from China is 15.5 percent and for India 15.1 percent. China accounts for 29 and 21 percent respectively of the world's poor and deeply poor (those living on less than \$1 a day).



India represents 27 and 40 percent of poor people in each of the two groups. The trade-weighted tariffs on labor-intensive exports from China and India are multiplied by these population shares to determine the contribution of the two countries in the effective tariffs faced by each of the two groups of poor. But China and India also account for 19 and 4 percent, respectively, of the world's nonpoor. These population shares, along with the “all-inclusive” trade-weighted tariffs faced by China and India (estimated at 8.3 and 8.5 percent) are used in the calculation of effective tariffs faced by the nonpoor.

Source: World Bank staff calculations.

Domestic policies to create export opportunities

Developing countries have gone a long way toward removing many of the domestic obstacles to export-led growth. Tariffs are lower everywhere, the anti-export bias embedded in the domestic trade regimes and sectoral policies has been reduced, while more sound macroeconomic policies have led to more competitive exchange rates. However, while macroeconomic policy and trade policy reforms were

ambitious, the pace of agricultural reforms has been uneven both at the commodity and country levels (Townsend 1999; Shepherd and Farolfi 1999; Akiyama and others 2001). Moreover a number of structural impediments hamper export diversification into manufactures in the poorest countries—especially in Sub-Saharan Africa (Fosu and others 2001).

Deepening the reform process in *two directions* is key to realizing the trade promise for growth and poverty reduction: (a) reducing

further tariff and non-tariff barriers to trade in a context of supportive policies that link the poor to expanded market opportunities and cushion transitional costs for any displaced group; and (b) building trade capacity by upgrading “behind-the-border” institutions, ranging from customs and ports to telecommunications and domestic transport.

Reducing tariffs and other barriers to trade can increase incomes, but adjustment costs cannot be ignored

Reducing tariffs and other trade barriers will not automatically lead to higher growth. Trade policy cannot substitute for a development program. However trade reform is an important component of a development strategy, and developing countries, with average tariff levels three times that of the high-income countries, have ample scope for capturing further gains from trade reform. Most analyses suggest that unilateral reduction in barriers can produce the greatest and quickest gains. Several countries have realized this and undertaken important domestic trade policy reforms—including Chile, China, and Costa Rica.

Improving integration into the world trading system involves lowering trade barriers and reforming domestic institutions in ways that may initially hurt low-income consumers, unskilled workers in sheltered industries, and previously shielded producers—especially subsistence farmers in remote areas with deficient rural infrastructure. Producers of import-competing commodities that receive disproportionate support may suffer from lower levels of protection, at the same time that poor consumers benefit from lower prices.

Even though the benefits from trade integration would eventually outstrip the costs, deployment of temporary safety nets—such as support to displaced producers and retraining—would help cushion the costs of dislocation for specific groups, and would ensure that trade-led growth is pro-poor (World Bank 1997, box 2.9). Efforts would also be needed to cushion the consequences for affected countries of the reorientation of export flows,

should the preferential market access regimes for specific commodities be discontinued. This would require increased donor support. At the same time, policy should remove distortions, with the aim of facilitating the redeployment of labor and released resources from the industry that enjoyed support. Although labor markets are inherently more flexible in developing countries, distortions—linked, for example, to state enterprise employment—often obstruct labor markets and hold back the adjustment to reforms.

Building trade capacity by upgrading “behind-the-border” institutions

If a country’s investment climate is poor and its institutions and infrastructure are weak, simply changing relative price incentives through trade policy may do little to promote sustained growth. In several cases, as for example, in Haiti (box 2.1), failure to respond to opportunities created by trade liberalization has been related to poor macroeconomic policies that have fed volatility and discouraged investment. Weakness of “behind-the-border” institutions can have a similar dampening effect, as occurs in transport, utilities, and communications. Improving regulation and competition in these sectors would strengthen the export response by reducing the cost of exporting. In agriculture, this is key to ensuring competitiveness in rapidly expanding markets for high-valued commodities where competition is stiff—such as, for example, fruits, vegetables, meats, and cut flowers.

Effective *duty drawback and indirect tax rebate mechanisms*, are important to overcome the anti-export bias often embedded in trade regimes. *Export finance* is often a major constraint inhibiting exports in many low-income countries. Inadequacies may result from the overall weakness of the financial sector or may reflect difficulties in assessing creditworthiness of traders. While ensuring availability of trade finance is a matter that needs to be left to the private sector, any effort to expand exports and to promote increased opportunities for the poor in the export sector needs

Box 2.9 Designing appropriate safety nets to ensure trade reforms are pro-poor

Since segments of the poor may be hurt by trade liberalization in the short run, determining the incidence of the tariff structure on the poor, and deploying appropriately tailored safety nets is important to ensure that subsequent growth is inclusive, and secure domestic support for reform. Deployment of safety nets raises two broad policy options: Employ general social safety nets, or establish safety nets targeted to those who are harmed by the trade reform (World Bank, 2001c).

Country-wide safety nets seem more appropriate than special safety net programs for trade-related problems. Fundamentally, it is difficult to justify safety net programs to poor people who suffer from trade reform and deny assistance to other poor people who suffer from unemployment from other disruptions, such as technological change, or domestic demand shifts. As the main need for the poor during a difficult transition period is likely to be food, one approach is a time limited food subsidy and distribution program. However, targeting a food subsidy is difficult, and often subject to abuse, while the benefits may also spillover to middle and upper income groups. An alternative is an untargeted subsidy on inferior goods, as has been pursued in Egypt (Adams, 2000).

Direct income support tends to be the most efficient type of social safety net. But proper management of means-tested programs of support requires important administrative capabilities, which poor countries often do not possess. One approach, which was employed successfully in Jordan, is to initially provide a money payment to a wide range of households, and subsequently narrow the program to only low-income families. Because distinguishing the poor from the non-poor may be difficult, workfare programs may be more generally applicable, and have been proven effective under certain circumstances (Ravallion, 1999), as individuals can self-identify for these programs.

The World Bank's Poverty Reduction Strategy Sourcebook outlines best practices for deploying social safety nets in event of dislocation. In addition, the Bank is working with other donors through the Integrated Framework studies to ensure that best practices are tailored to local capabilities and institutions. But there are no easy answers as liberalization affects the poor differently depending on country circumstances. The Bank intends to further deepen its knowledge and provide policymakers with analytical tools needed to answer some key questions.

Source: World Bank staff.

complementary policies to help overcome credit bottlenecks. Appropriately managed matching grants can be an effective instrument to assist small firms to penetrate export markets. *Product standards* based on international norms facilitate market linkages, and act as safety, health, quality, or environmental safeguards. Developing countries face a difficult challenge in this area, as they need to establish efficient testing, certification, and laboratory accreditation requirements to attain sanitary, phytosanitary, and product standards. Low-income developing countries need both technical and financial assistance to meet this goal. *Marketing of exports* is a challenging task for all low-income countries, because

they have to improve information on market opportunities; overcome problems of product and country brand; and meet concerns about quality. Foreign partners and FDI can be helpful in providing needed contacts and expertise. But local associations of exporters or producers can also help. Cooperatives and similar ventures can help improve marketing while ensuring that benefits from exports accrue to small poor farmers. However, transparency and competition in these institutions is important, or poor farmers may receive lower prices for their outputs.

In *agriculture*, in particular, where the stakes for poverty reduction are high, additional companion policies and institutions would be

needed to improve the supply response to market incentives. Some of these policies demand considerable up-front mobilization of resources, and should be backed by donor support. Examples include stepped up investment in rural infrastructure, which is a key enabler of agricultural exports in developing countries. Securing sufficient supply of credit at competitive conditions is important to encourage private sector investment into storage, transportation, and marketing of agricultural products. Increased investment in skills through education and training in rural areas is needed to bolster productivity in agriculture, and to enhance the ability of absorbing emerging technologies—especially those stemming from the biotechnology revolution.

But other initiatives in agriculture would need to improve the regulatory and policy environment. Continued trade policy reforms should redress the still remaining anti-export bias in developing countries' agriculture. Reforms of pricing policies should be stepped up, because in a number of LDC producer prices are still compressed compared to border prices, thus limiting export incentives.

Efficient land policies and land tenure institutions are also key to improving the functioning of land markets, securing property rights to farmland, and supporting the emergence of more efficient farm structures. Enhancing land rights and transferability can increase a farmer's ability to produce both for subsistence and for income, improve their incentives to invest, and enhance their ability to obtain credit (see also Freeman and others 2000).

High-income countries can help

Domestic policies in developing countries have a greater chance of success if high-income countries realize their interest in development success. One policy high-income countries can adopt is following the lead of the European Union. Its *"Everything but Arms"* proposal grants duty-free and quota-free access in all but 25 lines related to arms trade.¹⁵ Other Quad countries have also announced initia-

tives that extend existing preferential access to LDC or African countries, but they all fall short of a full coverage.¹⁶

A number of studies have found that the export growth gains for LDCs could be significant if *all* Quad markets granted duty-free access to LDC (Hoekman and others 2001; Ianchovichina and others 2001; UNCTAD 2001). The projected trade diversion and decline in other developing countries' exports are negligible, since LDCs represent only a small part of world merchandise trade, and other developing countries' exports are more diversified. According to a study (Hoekman and others 2001), even if all Quad members were to grant LDCs duty-free access for only tariff-peak items, non-oil LDC exports would increase by an estimated 11 percent, while other developing countries' exports would decline only marginally—by an estimated 0.1 percent.

Extending duty-free market access to *all* LDC exporters would also help mitigate the drawbacks of current preferential access schemes targeted on specific beneficiaries. These schemes often distort trade, because they displace low-cost producers elsewhere in the developing world. The case of the EU preferential regime for bananas illustrates this point (box 2.10). Moreover, preferential access to high-income country agricultural markets with highly subsidized domestic prices provides a premium over world prices to the countries receiving the preferences. This form of "aid-through-trade" is not an efficient way of providing aid because it creates dependence and is targeted to particular economic activities rather than to identified areas of need.

High-income countries can also provide "aid for trade." This could include increased grant aid for trade policy analysis (such as in the integrated framework program discussed in chapter 6), technical assistance on implementation of standards, and aid for aspects of development that affect the "soft infrastructure" of the investment climate, such as governance. No less important is disciplining the burgeoning recourse to contingent protection.

Box 2.10 The banana dispute: good intentions . . . bad policies?

Bananas are almost exclusively exported by developing countries to high-income countries, with the four dominant exporters (Ecuador, Costa Rica, Colombia, and the Philippines) accounting for three-quarters of global exports. The two major importers, the United States and the EU, cover approximately 60 percent of the world market, currently estimated between \$5 and \$6 billion.

During the 1990s, bananas were a source of trade dispute, often termed the “transatlantic banana trade war.” The trade dispute reflects primarily EU import policies. In 1997, 40 percent of the EU banana market was supplied by domestic production and duty-free imports from African, Caribbean, and Pacific (ACP) countries, with the rest being imported from non-ACP banana producers (the so-called “dollar bananas,” primarily from Latin America), who were subject to quotas and tariffs.

By restricting imports from non-ACP exporters, the EU import regime causes its domestic banana prices to be much higher than other markets—on average, about two-thirds higher than in the United States. Furthermore, the regime de facto guarantees high prices to EU and ACP producers, which has been the political justification for such intervention.

Apart from the income transfer from EU consumers to ACP and EU banana producers, a number of other effects are in place. High prices lower EU banana demand. If EU per capita banana consumption was the same as in the United States, total banana consumption in the EU would increase by more than 10 percent. This additional demand would raise world prices, while lower-cost banana producers would export more. The current quota/tariff combination is an inefficient and expensive way to provide aid. Borell (1999), for example, reported that for every dollar that ACP producers receive as aid through higher banana prices, EU consumers pay \$5.30.

Ecuador, Guatemala, Mexico, and the United States brought a complaint before the WTO in 1997. The panel ruled against the EU banana import regime. The EU has recently reached an agreement with the United States and Ecuador that allows more import licenses, based on historical allocation, until 2006 when ACP preferences will be retained only through tariff protection.

Source: World Bank staff.

Open regionalism could promote trade creation—

Regional arrangements continue to proliferate, and are likely to remain an enduring feature of the trade panorama. Smaller memberships make it easier to negotiate the increasingly important issues inherent in trade and regulatory regimes, while small countries often can exercise greater influence in regional arrangements.

“Open regionalism” holds the potential to stimulate global trade and improve the efficiency of regional producers. But regional arrangements can also become a vehicle for protection, trade diversion, and unintended inefficiency. Key conditions to benefit from expanded trade and investment include lowering common external trade barriers, stimulating

competition, reducing transaction costs, and reinforcing nondiscriminatory investment and services policies (World Bank 2001b).¹⁷

North-South regional agreements are more likely to improve welfare than South-South arrangements, because they usually result in lower trade barriers with less trade diversion, and because the greater structural differences in North-South economies produce greater gains from trade creation (World Bank 2000d). Although South-South arrangements can be made to work, a number of regional integration agreements have had negative or ambiguous effects on income. In particular, agreements between richer and poorer developing countries are likely to generate losses for the poorer ones when their imports are diverted

toward the richer members whose firms are not internationally competitive.

Reflecting large differences in costs between high-income and developing countries, North-South arrangements hold also the greatest promise for trade creation in agricultural products and labor-intensive manufactures. By contrast, a regional approach—even on a South-South basis—seems promising in the regulation of services, when combined with a nondiscriminatory approach to liberalization (Subramanian and others 2000). Possible areas of cooperation—by pooling resources and expertise and by upgrading and harmonizing standards—would include domestic regulation in sectors such as financial services, telecommunications, power, and transport.

—but multilateral policies hold the key to a sustained improvement in market access—

The next trade round has the potential to improve access for developing countries' merchandise exports to high-income markets, particularly in agriculture and labor-intensive manufactures, where the stakes for the reduction of poverty are high. The Quad countries—the United States, EU, Japan, and Canada—would serve their interest in expanding trade and development well if they put serious concessions on the table in these areas.

Offering to link “aid for trade” to progress in reforms in developing countries would also serve the interest of development well. The trade round should also provide more international aid and technical assistance in key sectors, such as agriculture, where the poor countries need to build trade capacity.

Developing countries too (especially the middle-income countries) should join multilateral efforts to further liberalize merchandise trade if they want to maximize the benefits from freer global markets. Because merchandise trade among developing countries is set to accelerate further, outpacing the growth of world trade, reducing trade barriers in developing countries holds a key promise in increasing the development impact of trade.

An agenda of multilateral trade policy options to make merchandise trade work for the poor would need to respond to three main challenges.

—reducing distortions in agricultural trade—

Removal of distortions to agricultural trade requires coordinated efforts in different directions. As a first priority, MFN-applied tariffs should be reduced, on average *by half* in high-income countries, and by one-third in developing countries. Agricultural tariff peaks in high-income countries should be phased out. Tariffs should also become more transparent by limiting the use of specific and compound tariffs. The EU and Japan should take the lead because in these countries tariff peaks on agricultural imports and specific tariffs are more prevalent. The size of tariff quotas should be increased and the “in-quota” tariff rates should be eliminated to improve the very low tariff quota fill rates, and the over-quota tariffs should be considerably cut to expand market access. Removal of tariff peaks in the Quad will help reduce the tariff escalation that hampers trade in more processed agricultural products and higher value-added manufactures. But multilateral surveillance should also be enhanced, to progressively eliminate tariff escalation in both high-income and developing countries.

As a second step, agricultural tariffs should be bound to levels close to MFN-applied rates, particularly in developing countries where bound rates are very high. Binding of tariff rates will improve the predictability of the global tariff system. High bound tariffs create ample scope for tariff protection to rise without infringing WTO commitments. Investors' risks could thus increase, limiting the benefits from more open trade.

The third step would require a much bolder overhaul of the system of support provided by high-income countries to agriculture. More binding disciplines should be introduced on production-affecting support, also encompassing subsidies that are currently exempt from URAA reduction commitments (“Blue Box,”

“Green Box,” and “*de minimis*” measures). As a benchmark, the producer support estimate in high-income (OECD-member) countries should be cut on average *by half* as a share of gross farm receipts. This should be coupled with an accelerated phaseout of export subsidies—especially in the EU, where their usage continues to be widespread. To level the playing field, officially supported export credits—which are more prevalent in the United States—should also be brought under multilateral disciplines.

—expanding access in labor-intensive manufactures—

The phaseout of the remaining quantitative restrictions in textiles and clothing should be stepped up, ahead of the ATC expiration in 2005, because the removal of quotas has been “back-loaded.” But this will not be enough to improve market access for developing countries. Applied tariffs in textiles and clothing remain excessively high and should be cut on average *by half* in high-income countries, and *by one-third* in developing countries. Tariff peaks should be phased out—especially in the United States and Canada where they are prevalent. Tariffs on footwear should be reduced across all Quad countries.

To build confidence that trade in textiles and clothing will be freed up in the post-ATC regime, the increasing trend in the use of contingent protection (especially in textiles) should be halted. Reducing the wide discrepancies between bound and applied tariffs would help build trust, because these discrepancies provide the scope for using tariffs as safeguards or for balance-of-payments reasons (Laird forthcoming). And multilateral surveillance should be enhanced, to eliminate tariff escalation on labor-intensive manufactures in both high-income and developing countries.

—and eliminating tariff peaks and escalation on all products

Eliminating tariff peaks that now discriminate against labor-intensive products would add considerably to the export potential of developing

countries. Similarly, reducing escalation in tariff codes in the developed and developing countries alike will produce more efficient, usually pro-poor growth.

Notes

1. Moreover, in Sub-Saharan Africa agricultural exports are concentrated in five major crops (cocoa, coffee, cotton, sugar, and tobacco), which, in 1990–95, accounted for an estimated 62 percent of total agricultural exports. Export concentration has hardly changed over time, since these same five crops represented 63 percent of total agricultural exports in the 1970s (Ingco and others 2001).

2. Export processing zones (EPZs) were often used extensively—for example, in Tunisia, Bangladesh, and Mauritius—to overcome the anti-export bias of domestic trade policy regimes and support export-oriented T&C industries. But their effectiveness in promoting spillovers to the rest of the economy has been questioned. By creating economic enclaves, EPZs often impair backward linkages with the rest of the economy, as the supply chain of exporting firms may rely more on imported, duty-free, intermediate goods than on local producers. Such impediments to local production linkages could be seen, for example, in the case of Bangladesh (World Bank 1999a).

3. The data on income distribution for the countries included in the sample are from household surveys reported in Deininger and Squire 1996, but in some countries household surveys measure expenditures, while in others they measure income. When household surveys report expenditure (47 out of 129 observations), consumption growth of the poorest 20 percent of the population is compared to growth in average per capita consumption—otherwise it is compared to growth in per capita GDP. Time periods span irregular intervals for each country—depending on the availability of household surveys of acceptable quality. To smooth out short-run fluctuations in income or expenditure, time periods span at least 3 years, with an average duration of 6.8 years. The geographical breakdown of the sample is: East Asia—31; Latin America and the Caribbean—50; Middle East and North Africa and Europe and Central Asia—15; South Asia—18; Sub-Saharan Africa—15.

4. In developing countries, applied tariffs are, on average, about three times higher than in industrial countries, partly because developing countries rely more on trade-related taxes to raise revenue. In developing countries, the coverage of nontariff barriers, including state trading monopolies, has also been considerably reduced (Martin forthcoming).

5. Tariff quotas allow a lower-tier, or “in-quota,” rate to be set at low levels, with the second-tier, or

“over-quota,” rate set at a higher level—close to the level of protection enjoyed before the URAA. The distribution of TRQs among countries and product groups reflects the incidence of tariffication. More than one-quarter of all tariff quotas apply to fruits and vegetables, with the next four more important groups being meat, cereals, dairy products, and oilseeds (WTO 2001).

6. Support to agricultural producers refers to the producer support estimate (PSE) computed by the OECD. The PSE is an indicator of the annual monetary value of gross transfers from consumers and taxpayers to farmers, measured at the farmgate level, arising from policy measures that support agriculture. These transfers include both government subsidies to agriculture (taxpayer transfers) and effective market price support through trade policies to restrict imports (transfers from consumers). A wider indicator of support, calculated by the OECD, is the total support estimate (TSE). In addition to transfers included in the PSE, the TSE also includes an estimate of general services support provided to agriculture—for example, public research and development, agricultural schools, inspection services, and infrastructure.

7. To be sure, the global impact of subsidy reduction in OECD countries on agricultural greenhouse gas emissions is uncertain, as production could increase in countries with higher emission intensity per unit of output.

8. In the EU and Japan, production-related total aggregate measurement of support (AMS) and “blue box” measures still account for the majority of support (83 percent in the EU and 53 percent in Japan), while in the United States support is now provided mainly under “green box” measures (84 percent).

9. Domestic support to agriculture is also high outside the Quad. For example, in the Republic of Korea, at an estimated \$17.3 billion on average during 1998–2000, the PSE covered 66 percent of gross farm receipts, and was more than four times higher than in Canada (OECD 2001b).

10. For example, in 1990 only about 58 percent of EU imports were under quota restrictions, which left much room to defer the “integration” of restrained products.

11. These high levels of protection also have a large cost for high-income countries’ consumers. According to a study, in 1997, quotas and tariffs on textiles and clothing cost to EU consumers about \$10 billion, while the loss of production efficiency due to the sheltering of domestic production will have cost another \$10 billion (Francois, Glismann, and Spinanger 2000). Hence, each job saved through the delayed freeing up of the EU textiles and clothing market costs an estimated \$24,000 per year in textiles and \$35,000 per year in clothing.

12. Other preferential schemes offer better access to some developing countries, such as those received by

African, Caribbean, and Pacific, southern Mediterranean and Eastern European countries in the European Union; and those received by Mexico, Israel, Andean countries, and the Caribbean Community in the United States.

13. LDC exports to the United States show an opposite pattern. However, high-preference exports represent less than 1 percent of LDC exports to the United States, which suggests that the outcome could be sensitive also to other barriers—such as standards, rules of origin, antidumping, safeguards, distribution, and so forth.

14. Trade-weighted applied tariffs may to some extent underestimate the degree of tariff protection, since highly restrictive tariffs, which are likely to reduce trade flows, receive small weights in the construction of the index.

15. However, for three sensitive agricultural products—bananas, rice, and sugar—the liberalization will be phased in during a rather lengthy transition period, to be completed by 2009 for rice and sugar, and 2006 for bananas.

16. Japan’s “99 percent Initiative on Industrial Tariffs” does not cover agricultural products where tariff barriers are particularly high. The U.S. “African Growth and Opportunity Pact” that grants duty-free and quota-free access to the United States does not include sensitive agricultural products (for which there are tariff quotas), nor apparel and clothing, which have their own preferential regime—including quotas and relatively restrictive rules of origin.

17. For example, Harrison, Rutherford, and Tarr (1997) estimate that Chile was able to profit from its free trade agreement with MERCOSUR due to the fact that it lowered its external uniform tariff from 11 to 6 percent.

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