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Trade Policies in the 1990s and the Poorest Countries

DURING THE 1960S AND 1970S, DEVELOPING economies exhibited severe trade-related distortions, including quantitative restrictions on imports and exports, very high tariffs, overvalued exchange rates, and administrative controls on foreign exchange allocation. Although growth remained rapid against a background of a favorable external environment up to the first oil shock in 1973, policies of import control and substitution induced inefficiencies as well as rigidities in economic structure. Often, they resulted in periodic balance of payments crises. Subsequently, the failure of many countries to adjust adequately to the external shocks of the 1970s and early 1980s underlined the importance of reforms designed to encourage responsiveness to market signals, improve the investment climate, and to enhance export diversification.

One result was that most developing countries implemented significant liberalization of their trade regimes during the late 1980s and the 1990s. Their export growth accelerated during the 1990s, and kept pace with the 6 percent per year expansion of world trade in volume terms. However, average per capita growth rates in developing countries as a group remained well below those of the rich countries in the 1990s. Though the giant low-income countries China and India embarked on market reforms and grew rapidly, growth in a large number of small, poor countries was disappointing. This led many observers to question the success of liberalization programs.

This chapter reviews the export and growth performance of developing countries in the 1990s, giving special attention to the poorest economies. It reviews the decline in trade barriers during the 1990s, examines output and export trends, and analyzes domestic trade-policy constraints. Finally, it considers external barriers to developing countries' efforts to accelerate their export growth.

The chapter reaches the following conclusions:

- Trade regimes were significantly liberalized during the late 1980s and 1990s. Developing countries cut the average tariff rate by half, narrowed tariff dispersion in many instances, and greatly reduced the incidence of nontariff barriers to trade. Most countries now rely on market forces rather than administrative fiat to allocate foreign exchange, and black market premiums have declined significantly. Although the degree of trade protection is still high in many developing countries, gross distortions in trade regimes have been greatly reduced.
- Despite the reforms and improved global economic conditions, developing countries' average real per capita incomes increased by less than 1 percent per year during the 1990s, compared with more than 2 percent in industrial countries. This outcome is partially affected by the political shocks and various foreign and

civil conflicts. Eighteen developing countries were severely affected by conflict, and as a group they suffered declines in per capita income of more than 1 percent per year. Incomes also fell in most transition economies following the breakup of the Soviet Union. Excluding countries hit by these severe political shocks, developing countries saw per capita incomes rise by 1.5 percent a year, about 1 per cent faster than in the 1980s.

- These countries also saw merchandise export growth of 6.4 percent per year during the 1990s, about 2 percent faster than during the 1980s. Export outcomes were very uneven, however. Regions that saw the largest declines in trade barriers, including East Asia, South Asia, and Latin America also saw the largest acceleration in exports. By contrast, growth in export volumes in Sub-Saharan Africa averaged only 2 percent per year, in part because world trade of the products Africa exports grew at half the rate of growth of world trade. Countries in Sub-Saharan Africa and in the Middle East and North Africa also saw market share decline in their traditional exports.
- The poorest countries were those most affected by conflict and political shocks. Ten of the 32 low-income countries were affected by conflict. Average per capita income of the low-income, small countries declined during the 1990s, but averaged 1 percent a year in real terms if countries involved in conflict are excluded. This represents a significant acceleration compared with the 1980s, but is still well below the average of middle-income countries. Exports also accelerated in the small low-income countries not involved in conflict, but grew about 3.5 percent slower than in the middle-income countries in the 1990s.
- Despite significant progress, many of the poorest countries have not put in place the policies necessary to raise living standards by improving (or even maintaining) export shares in traditional markets and en-

couraging rapid diversification. Appreciated real exchange rates and high real exchange rate volatility have often been associated with a muted export response to trade liberalization and other reform measures. Per capita income growth was significantly faster in countries with relatively stable real exchange rates. Additionally, institutional weaknesses, such as the absence of effective duty exemption/drawback programs, coupled with the need to use revenues from tariffs on intermediate and capital goods as a revenue source, have acted as an effective tax on exports in many of the poorest developing countries. Finally, weak export infrastructure, inadequate ancillary export services, and high transport costs—often in part the result of policy shortcomings—have left many of the poorest countries (particularly the landlocked ones) at a competitive disadvantage on international markets.

- External barriers to exports from developing countries, especially agricultural and labor-intensive products, continue to impede the integration of the poorest economies into the world market. While the share of developing countries in world trade of manufactures rose sharply in the 1990s, their share of world trade in agricultural products and processed foods has declined. In part this development is the result of domestic policies that restrain agricultural exports. But high trade barriers imposed by industrial countries on agriculture and processed food imports, and agricultural subsidies in industrial countries, are also important and have become even more important with the domestic policy reforms in developing countries. These barriers particularly penalize rural areas where the majority of the poor in developing countries reside, and impede growth in the poorest countries in areas of their comparative advantage. Various restrictions and subsidies in industrial countries also hamper the poorest countries' efforts to diversify into down-

stream processing, higher value added, and faster-growing products. The poorest countries are the least equipped to deal with these external barriers because a host of other domestic policy and institutional weaknesses inhibit their diversification into less restricted sectors.

Reductions in barriers to trade

Developing countries made substantial progress in reforming their trade and exchange rate policies during the 1990s. Tariffs were cut, their dispersion declined in many countries, fewer products were covered by quantitative restrictions (QRs), the number of countries allocating foreign exchange through administrative means (as measured by the International Monetary Fund) dwindled, and the black market premium narrowed. Although any one of these measures is an imperfect guide to the restrictiveness of the trade regime,¹ taken together they show enormous progress in opening the developing economies to international trade. Several studies have found that increased openness is associated with economic growth (box 2.1).

Tariffs. The average tariff rate in developing countries has been cut by at least half in the last 20 years, from 32 percent in the first half of the 1980s to 15.6 percent in the second half of the 1990s. Tariff reductions have been significant in most regions (figure 2.1), but have been largest in South Asia (where, however, they remain the highest of any region), Latin America, and East Asia. In many developing countries, the degree of tariff dispersion has also declined (table 2.1). Despite this progress, tariffs remain high in many countries, averaging more than 15 percent in three of the six geographical regions in 1996–98.

Latin American countries reduced tariffs substantially during the 1990s. Colombia, for example, slashed import tariffs by 65 percent in just one year in 1991, while Argentina and Nicaragua reduced them from an average of 110 percent to 15 percent in one bold move in 1992 (Dornbusch and Edwards 1995). India

reduced its average tariff from 100 percent in 1986 to around 33 percent in 1998, and Bangladesh's average tariff fell from 82 percent to 24 percent during the same period.

Tariffs in Africa have also been reduced, though more moderately: the average unweighted tariff remains at almost 20 percent. Some countries have embarked on rapid reforms, however. Tariffs fell in Kenya from 41 percent in 1980–85 to 13.5 percent in 1996–99 and in Guinea from 76.4 percent in 1978–80 to 10.8 percent in 1990–95. A few countries, such as Zimbabwe, increased their average tariffs (from 10 percent in 1980–85 to 22.7 percent in 1996–99), reflecting in part the conversion of an import surcharge into tariffs.³ The Middle East and North Africa region has seen little reduction in average tariffs, although the signing of trade agreements with the European Union in recent years by several countries in the region should eventually pave the way for significant reductions.

Nontariff barriers (NTBs). Developing countries in all regions have substantially reduced the coverage of NTBs (such as licensing, prohibitions, quotas, and administered pricing) during the 1990s (table 2.2).⁴ In many countries where NTBs remain more or less prevalent (for example, India and Korea), commitments have been made to liberalize them in the future (Michalopoulos 1999). NTB coverage has been reduced significantly in a number of Latin American countries, with the remaining NTBs mainly on agricultural products (Dornbusch and Edwards 1995). Most countries in South Asia have reduced NTBs significantly, though India still has restrictions on a relatively large number of imports.

Exchange rate regimes. The 1990s also saw a general move toward market-based foreign exchange regimes. In 1991, 66 countries had restrictions on payments for current account transactions, but by 1995 only 28 did (table 2.3). Many countries also undertook significant exchange rate reforms. The average black market premium for developing countries, one indicator of the restrictiveness of foreign exchange allocations as well as of macro-

Box 2.1 Openness and growth—evidence, old and new

A large number of cross-country empirical studies have documented a strong relationship between trade and growth.² Dollar (1992) finds that two separate measures of trade restrictions (an index of real exchange rate distortion and an index of real exchange rate variability) are negatively correlated with growth in developing countries. Sachs and Warner (1995) find that an openness index reflecting tariff and nontariff barriers, the black market premium, and the existence of commodity marketing boards has a high and robust negative coefficient in growth equations. Ben David (1993) finds that income levels in countries that joined the European Common Market have tended to converge toward the level of the richest partners. Similar studies have documented income convergence among states within the United States. Edwards (1997) finds a significant, positive relationship between openness and productivity growth, which is robust to several different measures of openness. In a recent study designed to identify measures of openness that cannot be said to be affected by economic growth, Frankel and Romer (1998) find that countries that are geographically closest to centers of demand have grown faster.

The positive relationship between openness and growth has also been supported by numerous case studies (Bhagwati 1978; Little, David, Scitovsky, and Scott 1970; and Papageorgiou, Choksi, and Michaely 1991), firm-level analyses (Bigsten and others 1998; Clerides, Lach, and Tybout forthcoming; and Kraay 1997), as well as a combination of economic theory and anecdotal evidence dating back at

least to Adam Smith. But the statistical relationship identified by cross-country studies is still occasionally challenged by researchers. For example, a recent analysis (Rodriguez and Rodrik 1999) raises several questions about the findings, and argues that the advocates of trade liberalization claim too much. In some cases the indicators of openness that researchers use as measures of trade barriers are highly correlated with other sources of poor economic performance, including macroeconomic policy, or they imperfectly reflect a country's trade policy regime. For example, most of the explanatory power of the Sachs and Warner index is derived from just two indicators—the black market premium and state monopoly over major exports. These two indicators are correlated with a wide range of macroeconomic policy and institutional factors other than trade openness, and thus yield an upward bias in the estimation of trade restriction effects. Rodriguez and Rodrik (1999) underline that tariff and nontariff barriers, two variables that directly measure trade openness, have little explanatory power when considered separately in the cross-country regression studies.

It is perhaps not surprising that the effects of trade reform are difficult to isolate statistically, since trade liberalization is rarely implemented as a stand-alone policy measure, nor is such a course recommended. It has long been accepted that trade liberalization needs companion policies to be successful, often including other market reforms, macroeconomic stabilization, exchange rate adjustment, and adequate safety nets. (See, for example, World Bank 1997b.)

economic imbalances, fell almost 70 percent between the 1980s and the 1990s.⁵

The average black market premium has remained low or fallen further in all regions. East Asian countries have had low black market premiums in recent years because they were early adopters of an outward-oriented development strategy. Latin America also achieved impressive gains in the late 1980s, and South Asia in the first half of the 1990s. In Sub-Saharan Africa and in the Middle East

and North Africa, the considerable reductions in black market premiums in many countries are masked by two outliers (table 2.4).

Reforms by income group. The trend toward lowering tariffs and eliminating foreign exchange restrictions is evident in both low-income and middle-income countries. The average tariff rate for low-income countries fell from almost 45 percent in the early 1980s to 20 percent in the late 1990s, only slightly above the average rate for middle-income

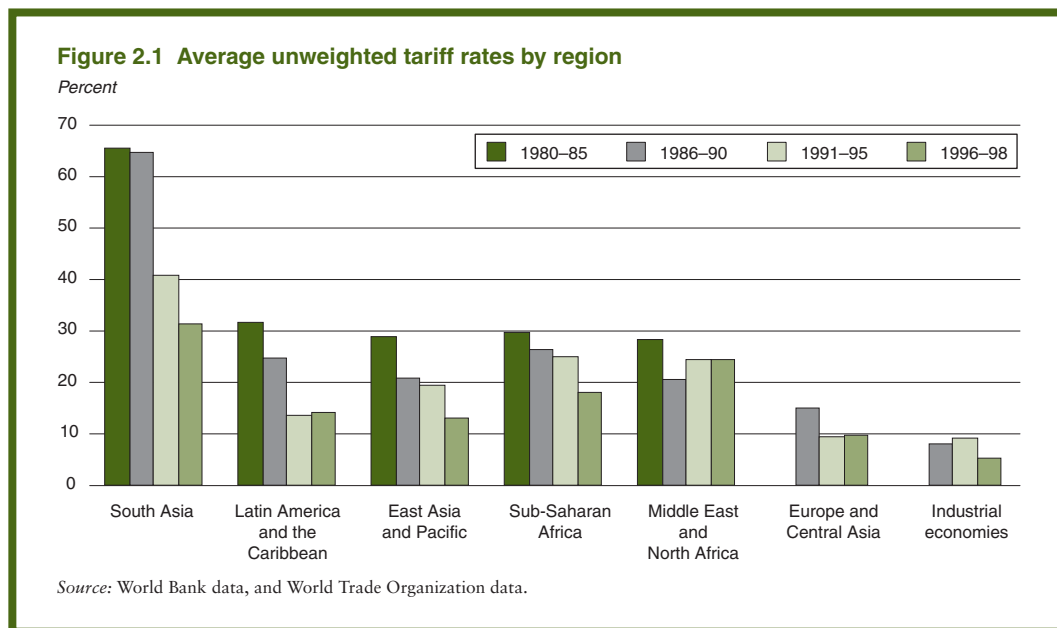


Table 2.1 Standard deviation of tariff rates

	1990-94	1995-98
<i>South Asia</i>		
Bangladesh	114.0	14.6
India	39.4	12.7
Sri Lanka	18.1	15.4
<i>Sub-Saharan Africa</i>		
South Africa	11.3	7.2
Malawi	15.5	11.6
Zimbabwe	6.4	17.8
<i>East Asia and Pacific</i>		
Philippines	28.2	10.2
Thailand	25.0	8.9
Indonesia	16.1	16.6
China	29.9	13.0
<i>Latin America and the Caribbean</i>		
Argentina	5.0	6.9
Brazil	17.3	7.3
Colombia	8.3	6.2
Mexico	4.4	13.5
<i>Middle East and North Africa</i>		
Egypt, Arab Rep. of	425.8	28.9
Tunisia	37.4	11.7
Turkey	35.7	5.7

Notes: Country observations are for one year in the time period noted above.

Source: World Bank, *World Development Indicators* 1998; 2000; WTO, *Trade Policy Reviews*.

countries (figure 2.2). By the late 1990s, most of the low-income countries had eliminated current account restrictions and reduced the black market premium to negligible levels.

Trends in trade and economic growth

The lowering of trade barriers and widespread adoption of market-based foreign exchange regimes during the 1990s was ac-

Table 2.2 Frequency of total core nontariff measures for developing countries, 1989-98

Region	1989-94	1995-98
East Asia and Pacific (7)	30.1	16.3
Latin America and the Caribbean (13)	18.3	8.0
Middle East and North Africa (4)	43.8	16.6
South Asia (4)	57.0	58.3
Sub-Saharan Africa (12)	26.0	10.4

Notes: Average number of commodities subject to nontariff measures as a percentage of total. Figures in parentheses are the number of countries in each region for which data are available.

Source: Michalopoulos 1999.

Table 2.3 Countries imposing restrictions on payments for current account transactions
(percent)

Region	1980	1991	1995
East Asia and Pacific (9)	33	33	22
South Asia (5)	100	100	40
Middle East and North Africa (6)	67	67	33
Sub-Saharan Africa (23)	85	83	39
Latin America and the Caribbean (30)	44	60	17
Europe and Central Asia (17)	...	94	47
Industrialized economies (12)	17	8	0
Total (102)	55	65	27

Notes: Figures in parentheses are the number of countries in each regional grouping.
Source: IMF, *Exchange Arrangements and Exchange Restrictions*, 1981, 1992, 1996.

Table 2.4 Average black market premium
(percent)

Region	1980–89	1990–93	1994–97
Total ^a	82.0	78.2	20.3
East Asia and Pacific	3.6	3.6	3.2
Middle East and North Africa	165.6	351.6	46.5
Excluding outliers ^b	7.1	8.8	1.4
Latin America and the Caribbean	48.7	13.1	4.4
South Asia	40.8	45.1	10.1
Sub-Saharan Africa	116.5	28.6	32.2
Excluding Nigeria	112.1	25.8	9.6

a. Sample of 41 developing countries.

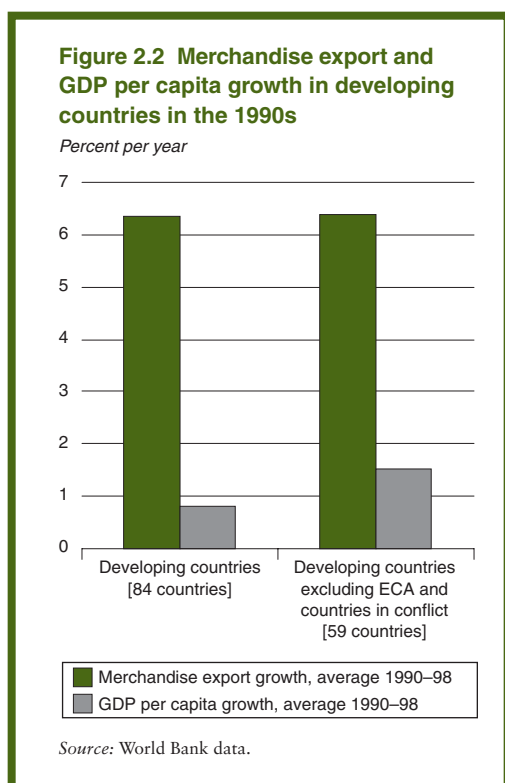
b. Algeria and the Islamic Republic of Iran.

Source: World Bank data.

accompanied by an acceleration of trade in developing countries. The improvement in the international environment in the 1990s, marked by lower interest rates and inflation but higher world trade growth and non-oil commodity prices than in the 1980s, also contributed to the acceleration of exports (table 2.5). Moreover, developing countries faced a more stable global economy in the 1990s, as the volatility of these key indicators declined. The growth of developing-country exports almost doubled in real terms, to 6.2 percent a year in the 1990s, compared to 3.7 percent a year in the 1980s.⁶ Per capita income also accelerated, though more modestly, from no growth in real terms in the 1980s to 0.7 percent in the 1990s.

The observation that developing countries as a group continued to exhibit relatively slow growth in per capita income in the 1990s—about one-third the rate of advance in the rich countries, despite large-scale liberalization and

export expansion, has sometimes been cited as evidence that increased integration with the global economy has not helped developing countries, particularly the poorest. In fact, output declines in countries that were hit by severe political shocks, including the breakup of the Soviet Union and various external or internal conflicts, had a large effect on the developing-country aggregates, and the rise of incomes in countries that did not suffer these calamities was considerable (table 2.6). Excluding the transition economies and countries involved in conflict, per capita GDP growth rates in developing countries averaged 1.5 percent per year during the 1990s, versus 0.4 percent in the 1980s, and export growth rates averaged 6.4 percent in the 1990s, compared with 4.3 percent in the 1980s. Furthermore, while developing countries became more open during the 1990s, volatility declined in most countries (see box 2.2).



With the exception of the countries in transition and conflict, there is little evidence that developing regions that engaged in rapid trade liberalization and companion reforms saw a deterioration in performance. In fact, developing regions that saw the largest reductions

Table 2.5 The international environment

	1980-89	1990-98
U.S. Real LIBOR	4.8	2.4
G-7 CPI (percent p.a.)	5.3	2.7
G-7 Real GDP growth (percent p.a.)	2.8	2.1
World Export Growth (percent p.a.)	4.4	6.4
Oil price (index, 1987 = 100)	138.4	113.1
Non-oil commodities price (index, 1987=100)	115.6	123.0

Source: World Bank data.

in tariffs during the 1990s also saw the most rapid increases in GDP and exports.⁷ GDP and export growth rates more than doubled in Latin America in the late 1980s and 1990s (table 2.7), a period that followed large advances in trade liberalization as well as the adoption of important macroeconomic reforms and widespread privatization. South Asia and East Asia also saw very sharp increases in export growth rates and continued high GDP growth. By contrast, countries in Sub-Saharan Africa and in the Middle East and North Africa made relatively less progress in reducing tariffs, and both GDP and export growth was considerably slower than in the other regions.

Factors affecting developing country exports. The acceleration of exports of developing countries in the 1990s reflected higher growth of world trade (itself a reflection in part of the increased integration of developing

Table 2.6 GDP and merchandise export growth rates

(percent per year, in constant prices; group simple average)^a

	GDP per capita		Merchandise exports ^b		Number of countries
	1980-89	1990-98	1980-89	1990-98	
World	0.6	1.2	4.1	6.4	133
Industrial countries	2.1	2.2	5.6	6.8	30
Countries that lack consistent data	-0.4	1.8	3.6	6.4	20
Developing countries (excluding those that lack consistent data)	0.3	0.7	3.7	6.2	83
Europe and Central Asia ^c	2.6	-1.1	0.4	7.6	6
Countries in conflict	-1.1	-1.3	3.0	5.0	18
Developing countries excluding ECA and countries in conflict	0.4	1.5	4.3	6.4	59

a. All growth rates are estimated using least squares for the sample periods.

b. Merchandise exports are deflated by constant 1987 U.S. dollar export prices.

c. To give comparable data over 1980s and 1990s, the republics of the former Soviet Union are treated as one country.

Source: World Bank data.

Box 2.2 Trends in volatility

The increase in openness and acceleration of growth during the 1990s were associated with a small decline, and not an increase, in the volatility of output and export growth in developing countries (see table). Output volatility increased significantly in countries affected by conflict and in Europe and Central Asia (ECA), but fell for other developing countries as a group and in three of the five geographic regions. Although open economies are more vulnerable to external shocks, especially when they are reliant on short-term capital flows (Easterly, Islam, and Stiglitz 2000), lower volatility in the 1990s may have resulted from less severe global economic shocks than in the 1980s. The 1990s were, of course, not tranquil for developing countries: they saw the breakup of the Soviet Union, the Gulf War followed by a global recession, the Tequila crisis, and

the global financial crisis of 1998–99. But the decade of the 1980s was characterized by much larger oil shocks that contributed to two global recessions and dramatically affected economic volatility of oil exporters. Partly reflecting the oil shocks, the industrial countries saw high inflation and international interest rates rose to high levels. The buildup of oil-related debts in the 1970s contributed to a massive debt crisis in developing countries that lasted most of the decade.

Policies, as well as luck, may have contributed to the modest reduction in volatility in the 1990s, especially lower inflation in both industrial and developing countries reflecting sounder macroeconomic policies. Increased integration with world markets may also have contributed to reduced volatility in countries where shocks originated domestically.

Volatility of growth rates

	GDP per capita (1987 US\$) ^a		Merchandise exports (1987 US\$) ^a		Merchandise exports (import prices deflator) ^b	
	1980s	1990s	1980s	1990s	1980s	1990s
All countries	4.5	4.2	15.2	14.1	17.9	15.2
Industrial	2.9	3.4	7.3	8.1	8.5	8.9
Developing	5.0	4.4	17.6	16.0	20.8	17.1
Conflicts	6.3	7.3	21.3	28.9	25.6	30.0
Europe and Central Asia	4.1	7.0	10.6	17.7	12.2	17.5
Other countries	6.4	4.1	24.8	19.6	28.0	18.1
Developing excluding ECA and countries in conflict	4.8	3.6	17.3	13.2	20.3	14.4
Sample	4.3	3.5	15.1	11.2	18.0	13.2
East Asia	3.8	4.6	10.4	10.8	12.8	9.1
Middle East and North Africa	5.0	3.6	15.4	7.7	21.7	14.0
Latin America and the Caribbean	4.3	2.7	12.6	13.0	15.6	14.6
South Asia	2.1	2.6	11.8	8.2	14.0	10.0
Sub-Saharan Africa	4.6	3.7	18.4	12.3	20.2	14.0

a. Standard deviation of growth rates expressed as a percentage in constant U. S. dollars.

b. Standard deviation of growth rates of merchandise exports, deflated by import prices and expressed as a percentage.

Source: World Bank data.

countries), as well as greater diversification of their export base and, for some developing regions, improved market share in traditional markets (table 2.8).⁸ While South Asia, East Asia, and Latin America saw both increases in market share in traditional markets and some

diversification, countries in the Middle East and North Africa and Sub-Saharan Africa saw some diversification, but a large decline in market share in traditional markets.

Sub-Saharan Africa stands out because the region experienced much slower growth of world

Table 2.7 GDP, services, and merchandise export growth rates

(percent per year, in constant prices; group simple average)

	GDP ^a		Exports				Purchasing power of GNFS exports ^c		Number of countries
	1980–89	1990–98	Merchandise ^a		Goods and services ^a		1980–89	1990–98	
			1980–89	1990–98	1980–89	1990–98			
Total ^b	3.1	3.8	4.3	6.4	4.5	6.3	2.2	6.2	59
East Asia and Pacific	5.4	6.3	5.7	14.5	5.9	14.3	4.1	13.7	7
Middle East and North Africa	3.6	3.4	5.3	6.0	5.5	5.0	0.2	3.3	9
Latin America and the Caribbean	1.8	3.6	3.9	9.1	4.8	8.1	1.6	8.8	14
South Asia	4.9	5.2	5.8	9.3	5.0	10.3	5.3	10.7	5
Sub-Saharan Africa	2.5	2.9	3.5	2.0	3.4	2.6	2.0	2.7	24

a. All growth rates are simple arithmetic averages of individual rates computed using least squares. Nonfactor services are deflated by constant 1987 GDP deflator; other series are expressed in constant U.S. dollars.

b. Refers to a sample of 59 developing countries.

c. Denotes average annual growth rate of GNFS export deflated by merchandise import prices.

Source: World Bank data.

Table 2.8 Decomposition of merchandise export growth for the sample countries

(percent per year, current U.S. dollars)

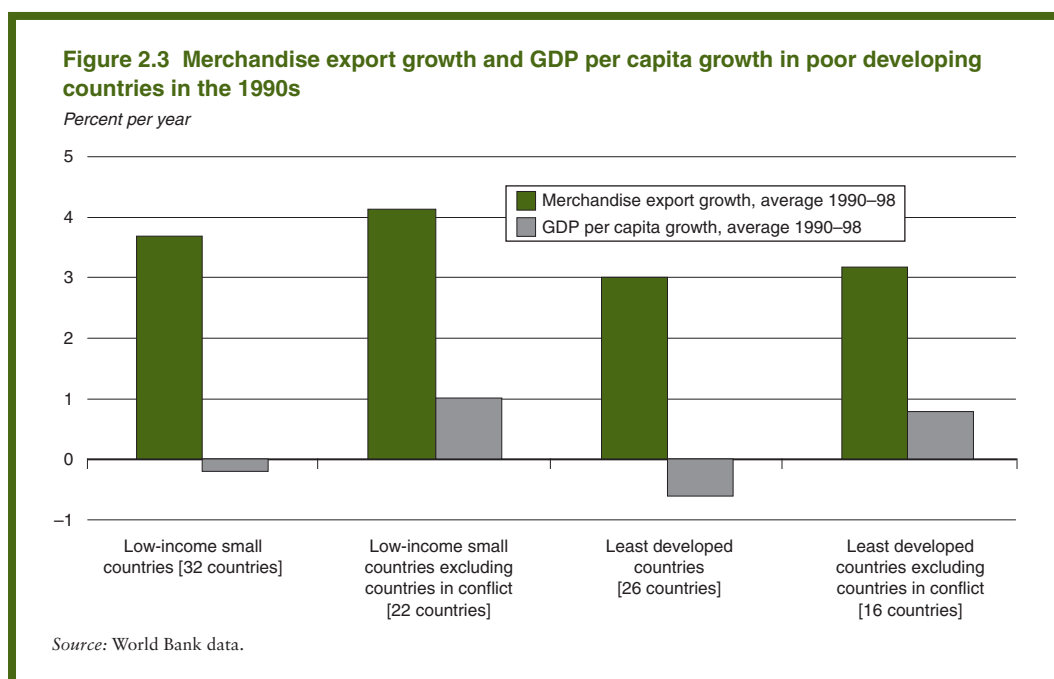
	Total Exports	1980/81–1989/90			Diversification	Total Exports	1989/90–1997/98		
		World Trade Growth	Market Share				World Trade Growth	Market Share	
Total	3.9	4.1	-1.0	0.8	5.9	5.4	0.0	0.6	
East Asia and Pacific	8.5	5.2	2.1	0.9	11.9	6.5	4.9	0.1	
Middle East and North Africa	2.4	3.1	-1.3	0.6	3.0	6.2	-3.5	0.5	
Latin America and the Caribbean	3.9	5.4	-2.2	0.8	8.3	6.7	0.6	0.9	
South Asia	8.9	5.9	1.5	1.5	10.0	6.4	2.8	0.6	
Sub-Saharan Africa	1.0	2.9	-1.6	0.8	3.0	3.8	-1.2	0.6	

Source: COMTRADE database, and authors' calculations.

trade in its export basket in both decades than other developing regions. Reflecting the continued decline in primary commodity prices and low-income elasticities of demand, world trade growth rates during the 1990s were less than 2 percent annually for exports of some of the poorest African countries, including Benin, Chad, Mali, and Mauritania, among others.

Trends in the poorest developing countries. Excluding China and India, which saw

significant increases in per capita incomes in the 1990s, per capita income declined in the 1990s in the poorest developing countries as a group (figure 2.3). Since 1980, 10 of the 32 low-income countries with consistent data have been involved in foreign or civil wars (see box 2.3). In 1999, one African in five lived in a country severely disrupted by conflict (World Bank 2000a). Excluding countries affected by conflict, per capita GDP growth rates in small



low-income countries averaged 1 percent per year during the 1990s, well below the 1.5 percent rate of growth achieved by middle-income countries (table 2.9).

Merchandise export volume growth rates in the 22 small, low-income countries (exclud-

ing countries affected by conflict) averaged only 4.1 percent per year during the 1990s, up from 2.9 percent in the 1980s but still well below performance in the middle-income countries. More than two-thirds of these small low-income countries (16 of 22) are in Sub-Saharan

Box 2.3 Economic factors contributing to conflict

There is a large body of literature documenting the negative impact of wars and rebellions on a country's growth performance, and there is also evidence that economic factors also contribute to conflict. Using a panel data set for 161 countries, Collier and Hoeffler (1999) find that among other factors, the risk of civil war is significantly and negatively related to growth in per capita income. A reliance on exports of primary commodities is positively related to civil conflict. For a country with a primary commodity export share of around 0.26, the risk of a civil war is around 23 percent (compared with 0.5 percent for countries with no natural resource exports), in part because the capture of resources either

motivated or made possible several rebellions. Diamonds in Angola and Sierra Leone and drugs in Colombia are some obvious examples.

Countries that are commodity-dependent are subject to larger external shocks. Rodrik (1998) argues that while external shocks can lead to distributional conflicts, societies that are cohesive and have strong institutions can adjust more easily to such shocks and avoid conflict. He compares Brazil, Korea, and Turkey, all of which suffered sharp trade declines during the 1970s. Korea was the hardest hit, as it was more open than either of the other two, but it recovered much faster. Adjustment was delayed in both Turkey and Brazil, and they witnessed considerable turmoil.

Table 2.9 Growth rates by income level for the sample countries*(percent per year)*

	GDP		Merchandise exports		GDP per capita		Number of countries
	1980s	1990s	1980s	1990s	1980s	1990s	
Total	3.1	3.8	4.3	6.4	0.4	1.5	59
Low income (large countries)	7.9	8.4	6.7	14.1	6.1	6.9	2
Low income (small countries)	2.7	3.6	2.9	4.1	-0.1	1.0	22
Least developed	2.2	3.5	2.9	3.2	-0.6	0.8	16
Middle income	3.0	3.6	5.1	7.4	0.5	1.5	35

Note: The sample (59 developing countries) excludes countries in conflict, transition economies, and those with limited data.

Source: World Bank.

Africa. An important factor accounting for the slow growth of the poor countries' exports was slow growth of world trade in their traditional export baskets. Several of the poorest developing countries lost market share in traditional exports and were unable to diversify rapidly enough into new products.

Summarizing, developing countries not in conflict and not in transition saw significant acceleration in incomes and exports in the 1990s, following adoption of trade and companion reforms. The poorest small countries were among those most affected by conflicts and political shocks. The poorest small countries that avoided these calamities performed better, but still not as well as the middle-income countries, on average. Thus, despite significant progress, it appears that policy regimes in many of the poorest countries are still inadequate to improve or even maintain export competitiveness in traditional markets or to encourage rapid diversification. The next two sections will discuss the key trade-related policy impediments to rapid integration of the poorest countries in the world economy, including trade barriers to their exports in industrial countries.

Weaknesses in domestic trade-related policies

Domestic policies that directly restrict exports or deter investment in the export sector remain important in most of the poorest developing countries (Yeats and others 1997). Policies that tend to discourage investment in

the export sector include overvalued real exchange rates, inconsistent or erratic macroeconomic policies, a high share of government spending in aggregate expenditure, excessive reliance on tariff revenues and on taxes on agriculture, and a variety of direct public interventions in product and factor markets, especially price controls and requirements that bank credit be allocated to the public sector (World Bank 1989, 1994, 2000a). Weak infrastructure and inadequate provision of ancillary services to exports also severely constrain export performance in many countries. As discussed in previous sections, some of the most severe policy distortions present in developing countries in the 1980s are being alleviated: average inflation and fiscal deficits have declined significantly (Easterly 2000); real exchange rates have been adjusted in many cases; tariffs and quotas have been cut; and export taxes and restrictions on agriculture have been reduced or eliminated in many countries.

This section examines three aspects of trade-related domestic policies that remain important impediments to integration of many of the poorest developing countries into the global economy: overvalued and unstable real exchange rates, high cost of imported inputs for exporters, and the higher costs of transportation and other trade-supporting infrastructure.

Exchange rate management. A competitive and stable real exchange rate ensures that producing tradable goods is profitable, and to underpin investor confidence in the export sector. In many of the poorest countries, protracted episodes of real exchange rate overval-

uation have impaired the competitive position of local firms. At different times, they have contributed to unsustainable trade deficits, and prompted increased tariffs, quantitative restrictions, and foreign exchange controls in futile attempts to contain these deficits. Episodes of overvaluation have also resulted in foreign exchange crises, economic instability, and the deterioration of growth over the long run. At the same time, unsustainable macroeconomic policies have also contributed to the overvaluation of real exchange rates (Bhagwati 1978; Krueger 1978; Papageorgiou, Choksi, and Michaely 1991; and Rodrik 1996).

The effects of real exchange rate overvaluation have been studied extensively. Dollar (1992) shows that Africa and Latin America had relatively overvalued exchange rates and large real exchange volatility, while East Asia had relatively undervalued exchange rates lower real exchange rate volatility, and more rapid growth. Using a wide variety of measurements and techniques, econometric studies have fairly uniformly found that overvaluation and associated real exchange rate volatility are negatively correlated with both export and GDP growth.⁹

The factors that lie behind protracted episodes of real exchange rate overvaluation, despite awareness of their adverse implications for growth, are varied. They include use of the exchange rate as a nominal anchor for the stabilization program and difficulties in exiting from the peg; rigid exchange rate regimes that fail to accommodate secular deterioration in the terms of trade and adjust to widening productivity differentials; disproportionate influence of urban elites who are consumers of imported consumer goods; concerns about the effect on the urban poor dependent on imported food staples or energy; and aversion to incur the immediate fiscal costs revaluing foreign currency liabilities.

Perhaps because of increased openness, in recent years policymakers appear to have become more aware of the need to maintain competitive and stable real exchange rates. The average exchange rate of developing coun-

tries depreciated during the 1990s (Easterly 2000), and many countries adopted more flexible nominal exchange rate arrangements.¹⁰ In some cases, for example the CFA countries (see box 2.4), these efforts resulted in a sharp turnaround in economic performance.

Several of the poorest countries failed to achieve stable and competitive real exchange rates during the 1990s. Overall, the average volatility of real exchange rates in the small, low-income countries increased. High exchange rate volatility was associated with weak economic performance. Among the countries in our sample (excluding countries affected by conflict), the poor countries that exhibited low exchange rate volatility saw exports rise at over 6 percent a year and per capita incomes rise at nearly 2 percent a year, much faster than countries with high exchange rate volatility (figure 2.4).

As countries became more open to international trade, the adverse effects of real exchange rate volatility on stability and growth may have become even more severe. In some cases, trade liberalization combined with sharp real exchange appreciation severely impaired the profitability of domestic firms.¹¹ Exchange rate overvaluation and high volatility also has a negative effect on investor confidence and can delay the supply response to liberalization.¹² Figure 2.5 shows six countries in Africa that moved to flexible exchange rates and liberalized their trade regimes during the early 1990s. These countries subsequently experienced appreciation and high volatility of the real exchange rates and low rates of growth. Per capita income growth in these six countries averaged only 0.5 percent a year in the 1990s, and their export effort (changes in market share and diversification) fell by 2.3 percent a year.

The causes of high real exchange rate volatility have been widely explored. They include unstable or inconsistent macroeconomic policies, which result in inflationary pressures and high fiscal and current account deficits. Many countries have tried to maintain stable nominal exchange rates, despite the formal

Box 2.4 Exchange rate overvaluation in the CFA countries

The CFA countries provide one of the most striking examples of the impact of exchange rate overvaluation on growth and the gains from improved exchange rate policies. The currencies of these countries are tied to the French franc, and at various times the appreciation of the franc, deterioration in the terms of trade, and higher inflation in CFA countries contributed to a highly appreciated currency that tended to depress export and GDP growth, the latter to less than 1 percent per year for 1986 to 1993 (see box table). The CFA franc was devalued in 1994, and GDP growth accelerated to 5 percent per year from 1994 to 1998. Export growth also accelerated, reflecting improved market share in traditional products and greater diversification, as well as acceleration of world trade in the CFA countries' export products: export effort, which measures

the annual rate of increase in exports due to rising market shares and diversification, rose from -4.8 percent per year in 1986-93 to 7.8 percent per year in 1994-98.

Exchange rates and CFA countries

	1986-93	1994-98
Average GDP growth	0.7	4.7
Average REER index	99.4	63.0
Export effort ^a	-4.8	7.8

Note: The countries included are Burkina Faso, Cameroon, Central African Republic, Chad, Côte d'Ivoire, Gabon, Mali, Niger, Senegal, and Togo.

a. The merchandise export growth rate achieved through changes in market share and export diversification.

Source: IMF, *International Financial Statistics*.

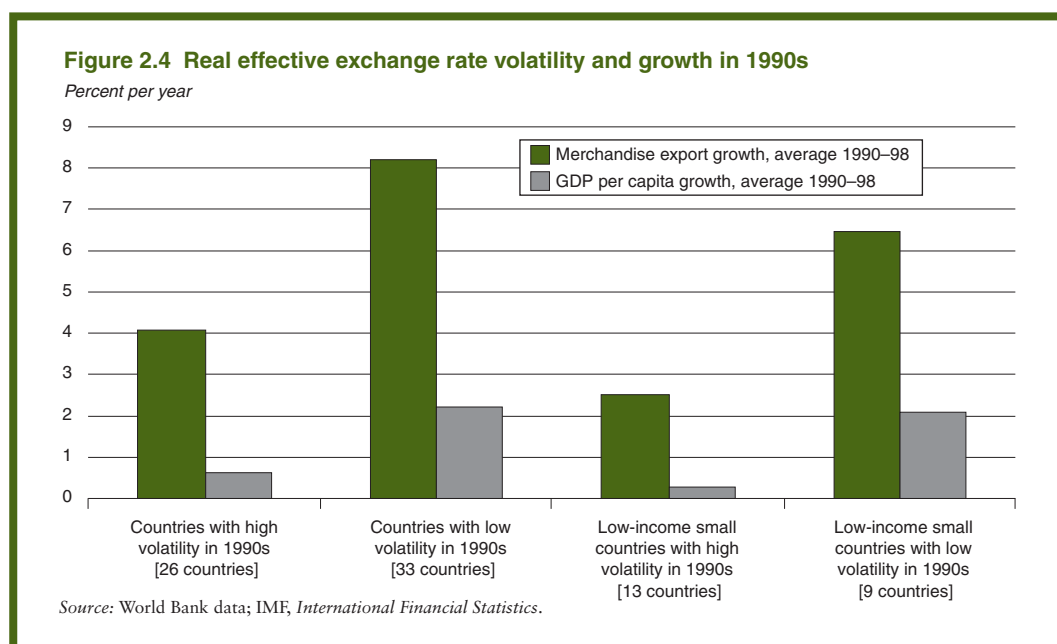
adoption of more flexible exchange rate regimes during the 1990s (Calvo and Reinhart 2000).¹³ However, attempts to maintain nominal exchange rate stability in the face of high and variable inflation rates or various domestic or foreign shocks imply that the real exchange rate will be volatile. For example, 17 of the 26 countries that exhibited high real exchange rate volatility were also rated by the World Bank as exhibiting relatively unstable macroeconomic policies.¹⁴ Among the 22 low-income countries in our sample, only two managed to achieve both macroeconomic stability and low real exchange rate volatility.

In addition, terms-of-trade shocks are an important factor contributing to high real exchange rate volatility in commodity-dependent countries. Hausman and others (1999) cite the volatility of capital flows as a driving force behind the volatility of exchange rates in many middle-income countries, particularly in conjunction with large debts denominated in foreign currency.

Thus, the record of the 1990s underlines the difficulties that poor countries face in maintaining a stable and competitive real exchange rate, reflecting their thin foreign exchange markets, their vulnerability to weather-related shocks, and their dependence on primary commodity exports that are subject to sharp changes in price.¹⁵

Exchange rate policies are hampered by the lack of clear signposts as to the exchange rate regime that minimizes real exchange rate volatility. The choice of exchange rate regime will depend on many factors, including the currency composition of public and private external debt and domestic financial assets, the track record and credibility of the monetary authorities, and the nature of external and internal shocks.¹⁶

Free trade status for exporters. High tariffs coupled with inefficiencies in customs and tax administration have increased the costs of exporting from many developing countries. Access to inputs at world prices is critical to



export competitiveness, so that high tariffs on intermediate and capital goods can reduce exports, particularly of processed goods that require substantial intermediate inputs. At the same time, many developing countries depend on tariffs for an important share of government revenues. Thus governments often face a difficult tradeoff between the desire to encourage export production through low tariffs on imported inputs and the need to generate sufficient revenues.

Successful exporters such as the Asian newly industrializing countries, in the early stages of their export drive, have enabled export firms to obtain their inputs at world market prices through reimbursing tariff duties on inputs (duty drawback systems), providing exemptions on duties for exporters (duty exemption systems), and setting up export processing zones where intermediate inputs can enter the country free of duty.¹⁷ These systems have been effective in reducing or eliminating tariffs on exporters' inputs, while maintaining a tariff structure that meets the revenue needs of the government. These systems, however, require considerable administrative resources to

ensure that reimbursement or exemption is granted quickly and fairly.

By contrast, the poorest developing countries have faced severe difficulties in ensuring duty-free access to inputs by exporters, for two reasons. First, a substantial share of government revenues in many of these countries is generated from taxes on international trade. To reduce distortions affecting domestic production and to simplify administration, tariff reform in many poor countries involves increasing low tariffs while reducing peak tariffs (Falvey and Kim 2000; Harberger 1988). As a result, many of the poor countries have significant tariffs on intermediate and capital goods (table 2.10). Although the average tariff rates for this sample of 15 African countries are not high compared with those of many other developing countries (figure 2.1), the duties on capital and intermediate goods do represent a considerable tax on export production.¹⁸ These duties are essentially designed to collect revenues, rather than to protect domestic production.¹⁹

Second, most of the poorer countries lack the administrative resources required to establish effective drawback/exemption schemes.

Figure 2.5 Real effective exchange rate behavior in selected poor countries, 1993–99



Note: 1990=100, upward movement indicates appreciation.
Source: IMF, *International Financial Statistics*; World Bank data.

Table 2.10 Tariffs in selected African countries

	Average nominal tariff	Trade weighted average	Collection Rate	Share of tariff revenues
All goods	19.8	16.2	10.3	100.0
Capital goods	13.7	13.2	7.8	12.9
Intermediate goods	16.9	14.2	8.1	42.4
Consumer goods	23.6	15.3	10.9	22.4

Note: Textiles, energy, and passenger cars are not included in capital, intermediate, and consumer goods. Data are for 1996 for Benin, Burkina Faso, Cameroon, Cape Verde, Côte d'Ivoire, Ghana, Malawi, Mauritius, Senegal, South African Customs Union, Tanzania, Uganda, Zambia, and Zimbabwe; data for Mali are for 1997.

Source: World Bank data.

Attempts to establish such systems during the 1990s were generally not successful. The requirement of examining individual import transactions imposed a substantial administrative burden on exporters and the government. In many countries, the government failed to provide (or significantly delayed) promised reimbursements of duties paid on imported inputs.²⁰ Even exporters' value added taxes were not reimbursed consistently. Ongoing work on 15 reforming Sub-Saharan African countries shows that none had a working duty drawback system. Mauritius operated a successful export processing zone program, while Cape Verde and South Africa had low duties on intermediate goods. The 12 other countries imposed significant duties on inputs to export production without effective means of compensating exporters.

There is no easy solution for poor countries attempting to ensure duty-free access to inputs by exporters.²¹ Further efforts are required to strengthen the administration of customs and to increase reliance on other sources of revenues such as income taxes. However, such efforts take time. In the short term, depending on the structure of export activity (for example, degree of processing) and the level of institutional development, governments need to decide whether drawback/exemption systems or free trade zones are feasible, or alternatively whether reductions in intermediate and capital goods tariffs are necessary to encourage export production. Since all but five of the countries in table 2.10 have total collection rates of less than 10 percent it is possible to

move to a tariff structure that has zero or very low rates for capital and intermediate goods along with much lower rates for consumer goods (coupled with reduced exemptions).

Infrastructure for trade expansion. Weak infrastructure constrains economic growth in many of the poorest countries and has a severe impact on trade performance. A firm's ability to compete in the world economy depends in part on the cost and availability of supporting services, such as transport, communications, and finance. While some of the problems these countries face in providing adequate infrastructure and other services are to some extent the result of location, technological deficiencies, and a lack of capital, many of these problems result from restrictive regulatory policies that limit competition.²²

Many of the least developed countries have weak and expensive service suppliers. Amjadi, Reincke, and Yeats (1996) conclude that high transport costs in low-income African countries are a more important trade barrier than tariffs.²³ These high costs add to the cost of exporting, and (other things being equal) lower its profitability in many of these countries. Countries in Africa normally absorb all, or most, of the transport charges for penetrating external markets. Africa's net freight and insurance payments in 1990/91 were about \$3.9 billion, approximately 15 percent of the total value of the region's exports. For developing countries as a whole similar payments averaged 5.8 percent, about one-third of Africa's ratio. Thus, in order to be competitive, an average producer in Africa has to be 10 percent more efficient than

firms in other developing countries. For the 10 landlocked countries in Africa, average net freight and insurance payments in 1990 were 42 percent of their total exports, eight times the average for other developing countries.

Limão and Venables (1999) also find that higher transport costs and weak infrastructure explain a significant portion of Africa's poor trade performance. This is especially true for landlocked countries. Exporters from landlocked economies face final city destinations that are on average four times further from the sea than that of exporters from coastal economies. The median transport cost for landlocked countries is 58 percent higher than the median for coastal countries. Delays and coordination problems at the border, higher insurance costs due to uncertainty and delays, and direct charges made by transit countries also add to the transport costs of landlocked countries. Improving transport infrastructure in landlocked countries and their transit countries can dramatically reduce costs and increase trade flows. Improving a country's worldwide rank from the 75th percentile to the 50th percentile in the distribution of infrastructure quality would double the volume of trade.

Poor availability of communications and energy can also constrain exports. Unreliable service can be even more damaging to competitiveness than high costs. Production stoppages, missed delivery dates, and lack of reliable communications make it difficult to compete and become part of global production networks. Despite liberalization of the financial systems in many countries, access to credit is limited, interest rate spreads are high, and in many countries weakness in regulatory institutions have kept financial sector reforms from having their anticipated benefits.

Reforms are being undertaken in many developing countries to liberalize the policy regimes for these sectors. Foreign participation is being allowed to improve the level of technology and efficiency, and also to generate the financing for the required investments. The potential gains from these reforms and resulting investments are very large. For exam-

ple, allowing exporters to charter their own vessels in Côte d'Ivoire halved the costs of shipping bananas to the United States, and reduced cocoa freight costs one-quarter (World Bank 2000a). Improving the operating efficiency of the Nacala rail line through Mozambique, with little new investment, would increase the GDP of Malawi by 3 percent. These efforts may have a significant role in improving export performance over the next decade (AfDB 1999). Donors also are engaged in the efforts to help the low-income countries to overcome the major institutional impediments that inhibit their integration into the world economy (see box 2.5).

Protection in industrial countries

Import restrictions and subsidies in industrial countries limit the growth of developing countries' exports by supporting less efficient production in industrial countries. Export subsidies to industrial country producers further limit the expansion of developing-country exports to third markets. Moreover, these policies make it difficult for developing countries to diversify into products for which world demand is high or increasing, and in line with their evolving competitive advantage.

Industrial-country import restrictions. Although the average tariffs in the Quad (Canada, European Union, Japan and the United States) countries range from only 4.3 percent in Japan to 8.3 percent in Canada, their tariffs and trade barriers remain much higher on many products exported by developing countries (Finger and Laird 1987). The Uruguay Round contributed to a sharp decline in the use of nontariff barriers (NTBs) in the OECD. In the Quad, only 1.2 percent of tariff lines are subject to NTBs. However, most of the NTBs are found in agriculture (tariff quotas, for example)²⁵ and textiles and clothing (Multi-fiber Arrangement), where developing countries have a comparative advantage (Finger and Schuknecht 1999).

Products with high tariffs in Quad countries include (1) major agricultural staple food

Box 2.5 The integrated framework for least developed countries

The least developed countries (LDCs) are particularly disadvantaged by a lack of capacity to provide the minimal public and private trade facilitation services and infrastructure required to support international trade.²⁴ The Uruguay Round agreement included promises by industrial countries to provide technical assistance to help developing countries strengthen their trade services, but these promises were not binding, and the reality has been disappointing (Michalopoulos 1999; Wang and Winters 2000).

The Integrated Framework (IF) was established in 1996 to increase the effectiveness and efficiency of trade-related technical assistance to the countries, in part by strengthening coordination among participating agencies and ensuring that technical assistance is demand driven. Participating agencies are the World Trade Organization, the International Monetary Fund, the International Trade Center, the United Nations Development Programme, the United Nations Conference on Trade and Development, and the World Bank.

By the summer of 2000, 40 LDCs had completed the first step of the IF process (a needs assessment). The six international agencies responded, indicating areas in which they could assist. This process revealed little overlap in the activities of the agencies and substantial needs that required additional financing. Progress in organizing IF roundtables to mobilize donor resources proved difficult; by

August 2000 only five roundtables had taken place. In only one case (Uganda) did the roundtable lead to the commitment of new funds from donors.

An independent review of the IF, completed in June 2000, highlighted that recipients expected additional funding, while donors were hoping to increase the effectiveness of technical assistance through improved coordination among agencies. The report noted a lack of clear priorities, weak administration, and a lack of donor resources. The review recommended that trade needs be better integrated in national development strategies, that steps be taken to strengthen the secretariat and coordination functions, and that a trust fund be established for IF activities. Although the memberships and governing bodies of the core IF agencies broadly support the first four suggestions, to date there has been little concrete support for the trust fund proposal. Efforts are ongoing to mobilize the required resources.

The six agencies are committed to continue to deliver trade-related technical assistance to least developed countries within their existing resource constraints, pursuant to their mandates and competence. The World Bank's activities in trade policy, trade facilitation, and export development are primarily undertaken at the country level and based on the country's development strategy. Consequently, the Bank's efforts in mainstreaming trade will be driven by the priorities identified by each country's government.

products, such as meat, sugar, milk, dairy products, and chocolate, where tariff rates frequently exceed 100 percent; (2) tobacco and some alcoholic beverages; (3) fruits and vegetables—including 180 percent for above-quota bananas in the European Union and 550 percent and 132 percent for shelled groundnuts in Japan and the United States, respectively; (4) food industry products, including fruit juices, canned meat, peanut butter, and sugar confectionery, with rates exceeding 30 percent in several markets; and (5) textiles, clothing, and footwear, where tariff rates are in the 15 to 30

percent range for a large number of products. These are sectors in which developing countries have a comparative advantage.

For example, in the United States only 311 of 5,000 tariff lines are above 15 percent.²⁶ Yet 15 percent of exports from least developed countries to the United States face these tariffs (Hoekman, Ng, and Olarreaga 2000). Thus, there might be considerable potential for the least developed countries to increase their exports if U.S. tariffs were reduced.

Some of the highest tariff rates in industrial countries are applied to products that are

Table 2.11 Developing-country exports to Quad countries facing tariffs of more than 50 percent

Average most favored nation tariff (%)	113
Range of tariffs (%)	50–343
Exports to Quad (billion US\$)	5.0
Share of developing countries in total imports of Quad (%)	10
Exports to the world (billion US\$)	26.6

Source: OECD, 2000b; UN COMTRADE; and staff calculations.

typically exported by developing countries. For example, almost \$26 billion of exports from developing countries in 1999 to the world were products that would have faced tariffs above 50 percent in the Quad countries. Only about \$5 billion of that sum was actually exported to the Quad countries. On the other hand, Quad countries imported about \$50 billion of the same goods, most of it from other industrial countries.²⁷ This suggests some potential for developing countries to expand exports of these products to the Quad if the tariffs were lowered. Although \$26 billion is only about 2 percent of total developing-country exports, individual developing countries (including among the least developed countries in the above example) may be more affected.

The tariff rates in table 2.11 do not reflect the Generalized System of Preferences (GSP) and other preferential schemes operated by Quad countries. These schemes tend to reduce the tariff rates applicable to imports of these products from some developing countries. North-South preferential trade agreements such as NAFTA or the Euro-Mediterranean Agreements also provide duty-free entry for some developing countries.²⁸ However, in most cases where tariff peaks are present, the sensitivity of domestic industry to imports exclude various products from preferential schemes limit the amount that can be imported under the preferential rates, or restricts the number of countries that are eligible. For example, the United States has no GSP or least-developed country preference for products facing tariffs of more than 50 percent.²⁹ The EU limits pref-

erential margins and imposes country or sector quotas, or both (Michalopoulos 1999).

The potential for growing exports in the restricted categories is illustrated by those developing countries that have managed to accelerate their agricultural exports through free trade arrangements with industrial countries (see chapter 1 for a discussion of the benefits of North-South regional trade agreements). For example, since Mexico joined NAFTA in 1994, the value of its agricultural exports has increased by 15 percent per year—twice the rate of the previous five years. After joining the EU in 1986, Portugal’s agricultural exports grew by 9.2 percent per year in nominal U.S. dollars, and Spain’s exports grew by 10.9 percent. In the prior five years, both Portugal and Spain had seen declining export earnings from agriculture. These experiences suggest that further trade liberalization in agriculture is likely to have a major effect on developing countries’ abilities to increase agricultural exports.

Developing-country trade barriers. Developing countries’ exports are subject to much higher trade barriers in other developing countries than in industrial countries. The average tariff developing countries face in their exports of manufactures to other developing countries is 12.8 percent, more than three times the average tariff on their manufactured exports to industrial countries (table 2.12) (Hertel and Martin 1999). Tariffs in developing countries

Table 2.12 Average tariff rates by importing and exporting region (percent)

Exporting region	Importing region	
	High-income countries	Developing countries
Manufactures		
High-income	0.8	10.9
Developing	3.4	12.8
World	1.5	11.5
Agriculture		
High-income	15.9	21.5
Developing	15.1	18.3
World	15.6	20.1

Source: Hertel and Martin 2000.

Table 2.13 Producer support estimates for OECD countries

	Percent		US\$ billion	
	1986–88	1997–99	1986–88	1997–99
Lower-income OECD countries	37.5	28.7	28.8	39.4
Australia, New Zealand	9.5	4.5	1.8	1.4
Canada, United States	29.5	18.5	47.5	47.8
European Union	44.0	44.0	95.2	116.6
Other non-EU OECD	71.0	66.7	7.8	7.8
Japan	67.0	61.0	53.6	53.1
OECD	41.8	34.9	234.8	266.2

Source: OECD 2000a.

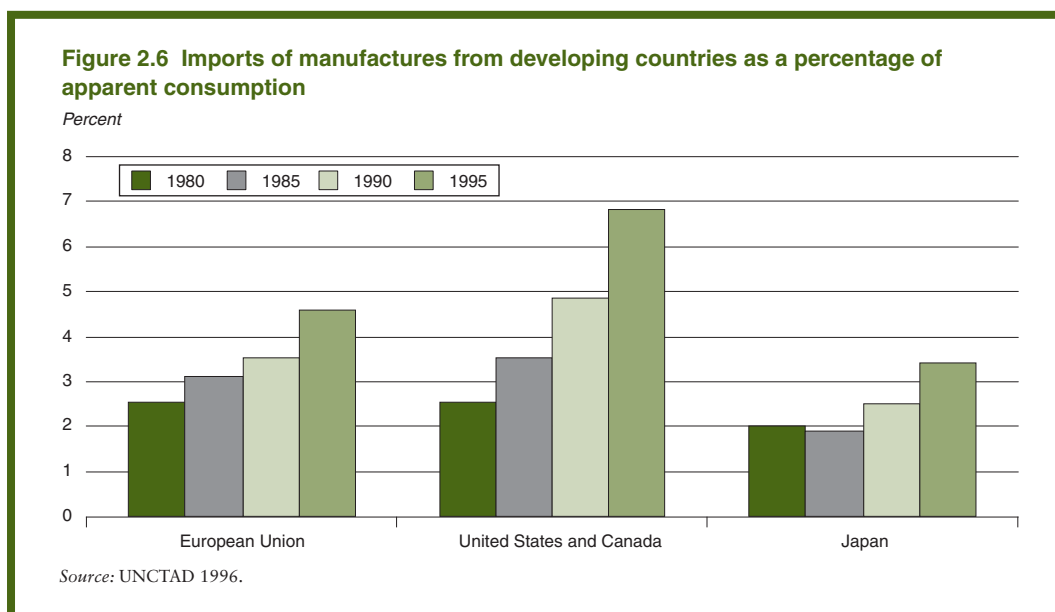
are somewhat higher in agricultural markets as well. These high tariffs are becoming all the more important to developing countries, as the share of South–South trade in their exports has risen from about 26 percent in 1980 to 40 percent in 1999.

Industrial-country agricultural subsidies. Agricultural subsidies in industrial countries limit the growth of developing countries' agricultural exports by supporting inefficient producers. Furthermore, surplus agricultural products have been exported at a loss, further reducing the opportunities for many developing-country producers in third markets. Estimates of agricultural producer support declined as a share of gross farm receipts between the mid-1980s and the mid-1990s. Over the past few years, however, when agricultural prices have declined, subsidies have actually increased.³⁰ By 1999 the average producer support estimate reached 40 percent, almost equal to the average of 1986–88 (table 2.13). Virtually all OECD countries, except New Zealand and Australia, have increased their support levels. The biggest increases in the rate of protection took place in lower income OECD countries but the largest subsidy in absolute terms was given by the EU. During 1997–99, the average annual value of subsidies was about 60 percent of total world trade in agriculture, and almost twice the value of agricultural exports from developing countries.³¹

The impact of trade restrictions on diversification and trade growth. The lowering of industrial country trade barriers has combined with improved efficiency in developing

countries to spur rapid export growth. The more successful middle-income countries have achieved rapid progress by increasing exports of labor-intensive manufactures, in part replacing production in industrial countries. This deceleration or decline in industrial countries' share in labor-intensive manufactures has allowed developing countries to increase their exports at a much higher rate than the growth of world income.³² By allowing the least-cost producers to capture a greater share of demand, the efficiency of global production has increased. Despite remaining quotas and other restrictions on many labor-intensive products (such as textiles), the shares of developing countries' manufacturing exports in world trade (figure 2.6) and in the consumption of the Quad countries have increased. But, even in 1995 the shares were not high—ranging from 6.8 percent of consumption in Canada and the United States to only 3.4 percent in Japan.

Tariff escalation in industrial country markets has restricted the market access of developing country producers of finished goods, thus hampering industrialization.³³ The Uruguay Round has made some progress in reducing the degree of overall tariff escalation. Yet, in a number of sectors (such as food processing) that are of particular interest to developing countries, high levels of tariff escalation are still present (box 2.6). Many products are also protected by some form of quota. As some of these quotas are allocated on the basis of historical trade shares, new and more efficient countries cannot enter these markets.



Developing country exporters of agricultural products have not achieved even the limited penetration of industrial country markets that occurred in manufactures. The share of developing countries' agricultural exports in world trade have actually decreased (figure 2.7). The relatively low level of developing country agricultural exports can be attributed in part to greater protection and subsidies in agriculture than in manufacturing. Higher protection allows only the most efficient agricultural producers in developing countries to enter industrialized country markets and relatively more inefficient producers in industrial countries to maintain their market share. The success of many developing countries in products that face lower protection and subsidies, such as cut flowers from Africa, and more stable trade shares in fruits and vegetables also suggest that if protection in agriculture is lowered, many of the poorest countries could expand their exports.³⁴

Implications for the poorest countries. While external constraints are not the primary reason for slow export growth and declining terms of trade of the poorest countries,³⁵ nevertheless, industrial country trade restrictions and subsidies are having an adverse impact on

growth and poverty reduction. Many of the poorest countries are still primarily agricultural exporters, 40 to 60 percent of their population (and the majority of the poor—World Bank 2000c) lives in rural areas, and expansion of agricultural exports is one of their few avenues to accelerating growth (at least in the medium term), given their level of technology and human capital base. Many of the poorest countries made progress during the 1990s in removing domestic policy constraints on agricultural exports; however, policy reforms and investments in rural areas, which are necessary for poverty alleviation, are unlikely to yield significant improvements unless the demand for many of these products can be expanded through exports to world markets.

Numerical estimates of gains from reduced agricultural protection vary considerably, but reducing protection could have a particularly important impact on the poorest countries. Ianchovichina, Mattoo, and Olarreaga (2000) show that if all the Quad countries gave free trade access to the low-income African countries, their net exports would increase about 6 percent. The negative impact of this expansion on other developing

Box 2.6 Food processing

Food manufacturing products are subject to high tariff levels and a high degree of escalation. In the European Union and Japan, fully processed manufacturing food products face tariffs almost twice as high as tariffs on products in the first stage of processing. In Canada, tariffs on fully processed food products are 13 times higher than for products in the first stage of processing. High nominal tariffs on goods with high degrees of processing imply even higher rates of effective protection (because the tariff rate is a relatively large percentage of value added).

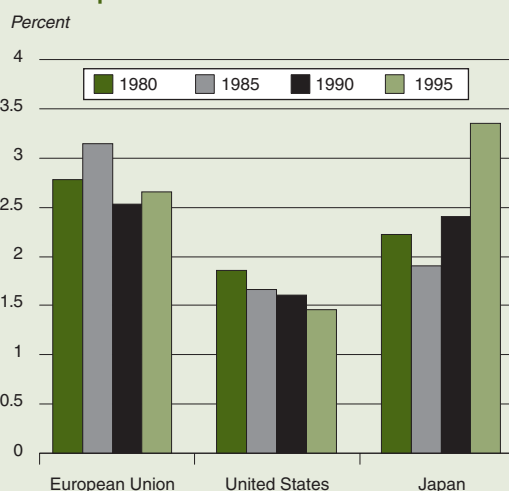
Partly because of these trade restrictions, the penetration of developing-country food exports has been limited, is much lower than average manufacturing, and has been declining in some markets.

Tariff escalation in food manufacturing
(percent)

	Canada	EU	Japan
First stage	3	15	35
Semiprocessed	8	18	36
Fully processed	42	24	65

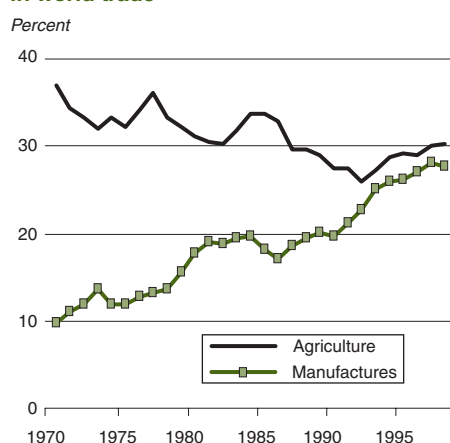
Source: WTO (several years), *Trade Policy Review—Quad Countries*.

Imports of processed food from developing countries as a percentage of apparent consumption



Source: UNCTAD 1996.

Figure 2.7 Share of developing countries in world trade



Source: FAOSTAT, World Bank data.

and on industrial countries would be negligible, because the absolute size of the increase is very small in comparison to the world trade.³⁶ Almost all the gains come from the expansion of agricultural trade. Hertel, Hoekman, and Martin (2000) report that a 40 percent reduction in industrial countries' agricultural tariffs and export subsidies by 2005 (a less radical assumption than in the paper cited above) would increase income in most developing regions by less than 1 percent.

However, one point needs to be underlined when discussing the trade barriers facing the exports of the poorest countries. Most of these countries have weak export-supporting infrastructure and skills that make it difficult to switch from domestic market to exporting, and vice versa, in response to changes in relative prices, or to diversify out of traditional com-

modities facing artificially constrained markets. These weaknesses are reflected in little export-market diversification, imperfect capital markets that do not provide adequate and timely credit, low capitalization of many enterprises, small numbers of firms, and a very difficult environment for transactions. The fact that many of these countries have a history of policy reversals and mismanagement implies that the credibility that must underpin investment is lacking. Thus they are in a much weaker position than some of the more successful countries to overcome industrial countries' barriers to their traditional exports through diversification.

Notes

1. For example, import-weighted calculations of average tariffs may understate the importance of very high rates that block all imports, while the number of QRs may not accurately reflect their impact on trade. Moreover, data availability for these series is uneven both over time and across countries. Nevertheless, they are preferable indicators of trade policy than many used in the literature (see Edwards 1997). Some of them (such as share of trade to GDP, or growth of exports) are endogenous variables that depend on location, country size, and other policies; some rank trade regimes as perceived by users (the Heritage index), while others measure the degree of trade distortions only at one point in time (the Sachs-Warner index). Most of these measures have even more limited country and time period coverage.

2. See Barro and Sala-i Martin 1995 for a review of the econometric literature. Sensitivity of results to both variables and specifications are highlighted by Levine and Renelt 1992 and Sala-i Martin 1997a, 1997b).

3. One concern is that in many developing countries tariff bindings have been applied to only a small percentage of tariff lines, and wherever applied, these ceilings in general have been higher than the actual applied tariffs. In a sample of 42 countries, the bound ceilings were 49 percent, while the average applied rate was only 18 percent. The large gap between tariff bindings and actual levels may make the government susceptible to protectionist pressures and creates uncertainty about the future direction of reforms.

4. These averages need to be used with caution, as data are available for only a few countries in each region and may not exist for both the time periods under consideration.

5. The black market premium is used here to measure the administrative allocation of foreign exchange for trade purposes. However, a large black market pre-

mium may also reflect the degree of overvaluation as well as capital account restrictions.

6. This chapter uses simple averages, which give equal weight to individual countries regardless of size. These figures differ from the weighted average growth rates reported in chapter 1 and the annex, which give greater weight to bigger countries. China and India in Asia, and South Africa and Nigeria in Africa, dominate the regional averages. Weighted averages are appropriate for measuring the total regional increase in GDP or exports, while simple averages are appropriate in analyzing the impact of policy on growth (since the relationship between policy and performance is just as relevant for a small country as for a large one).

7. Tariff reductions are clearly not the only determinant of export growth rates, and some regions with relatively high tariff rates (such as South Asia) had rapid growth in exports. Nevertheless, the reductions in tariff rates during the 1990s were, on average, associated with rapid export growth.

8. To measure the role of world trade conditions as opposed to other factors that determine export performance, export growth (in nominal dollars) is decomposed into three components using COMTRADE data: (a) growth caused by the expansion of world trade for products defined as traditional exports in the initial period, (b) gains in the share of individual countries in world trade in these commodities, and (c) growth attributable to diversification. COMTRADE data are not identical to the trade data used in the rest of the report. They are based on the reported imports from OECD and other reporting countries and cover about 90 percent of world trade. Because most countries in Sub-Saharan Africa and the Commonwealth of Independent States (CIS) do not report their imports fully, they underestimate intra-African and intra-CIS trade. The decomposition into growth in traditional markets, increased market share, and diversification depend on the definition of the traditional or initial export basket. In table 2.8 the export baskets of 1979–80 and 1989–90 were taken and all exports above US\$5 million were classified as major. Growth of new exports and exports that were less than \$5 million during the initial period are classified as diversified. (See Yeats 1998, and Ng and Yeats 2000 for a similar exercise.)

9. See Dollar 1992; Elbadawi 1998; Ghura and Grenness 1993; Razin and Collins 1997; and Sekkat and Varoudakis 2000. Edwards and Savastano (1999) have a critical review of the measures of exchange rate misalignment. See also Hinkle and Montiel 1999 and Williamson 1994 for a detailed analysis of the measurement issues and economic implications of exchange rate misalignment.

10. According to IMF, 97 percent of its members in 1970 were classified as having a pegged exchange rate; by 1999, this share had come down to very low levels

(Calvo and Reinhart 2000). As of 1999, of the 185 countries reporting their exchange rate arrangements, 84 had pegged regimes, 75 had floating rates, and 26 managed a system of limited flexibility. Of the countries with floating rates, 27 maintained a managed float, and 48 had an independent float (Shatz and Tarr 2000).

11. The fears of deindustrialization by many African countries are usually attributed to trade reform, while the exchange rate behavior probably played an even more important role.

12. Some studies have found a negative relationship between indicators of real exchange rate volatility and private investment (Aizenman and Marion 1995, 1996). Similar results were obtained by Darby and others 1998 for a group of five OECD countries and by Serven 1998 for developing countries. Other studies have found no relationship between real exchange rate volatility and aggregate investment (Bleaney 1996; Goldberg 1993; Ramey and Ramey 1995).

13. They cite various evidence, including the lower volatility of nominal exchange rates in developing countries than in several industrial countries, higher volatility of foreign exchange reserves than would be expected under floating rates, that countries use nominal interest rates to smooth exchange rate fluctuations, and that exchange rate rigidity occurs in the face of commodity price shocks.

14. The World Bank prepares ratings of developing countries' macroeconomic policy stances using a consistent framework, for the purpose of cross-country comparisons. Although exchange rate volatility macroeconomic stability ratings are highly correlated, the relationship is not perfect. There are twenty-one countries which either had high exchange rate volatility and were rated as having stable macroeconomic policies or vice versa. Only 16 countries managed to achieve both macroeconomic stability and low real exchange volatility. These countries also achieved much higher per capita GDP growth rates than other countries.

15. Thin markets lead to large changes in exchange rates due to small changes in demand and supply of foreign exchange.

16. A recent IMF study on exchange rate regimes comes to the same conclusions (Mussa and others 2000).

17. In many countries, initial policies did not include broad trade liberalization, but what can be called "compensatory" policies for exports. These range from elaborate input coefficients for duty exemption system in Korea and duty drawback systems in Taiwan to export processing zones, and so on, which gradually gave way to elimination of NTBs, lower tariffs, and opening up of the domestic economy. Mauritius relied on an effective free trade zone, while the success of Bangladesh garments is due to a well-working bonded warehouse scheme, which is a form of duty exemption system.

18. There has been significant tariff reduction since 1996 in most of these countries. Also, there are large differences among the countries included (the trade-weighted tariff ranges from 25 percent in Zimbabwe to about 7 percent in the South African Customs Union).

19. Many of these products do not have local substitutes, and it is unlikely that they will be produced in these countries over the medium term. In that sense, they are pure revenue tariffs.

20. See Nash and Fouratan 1997 for the experiences in Africa, and Rajapatirana 1997 for Latin America and the Caribbean.

21. Just lowering tariffs on intermediate and capital goods without corresponding reductions in tariffs on consumer goods will increase the effective rate of protection for domestic producers, and thus may impair the efficiency of resource allocation.

22. Most infrastructure services in developing countries are supplied by governments or public departments with administrative barriers to entry. This lack of competition leads to higher costs, poor maintenance, and a lack of investment for technological upgrading. Opening up many of these services to competition under a transparent regulatory environment will lower costs, attract foreign and private capital, and improve delivery of services. For examples of recent privatization and demonopolization efforts and their positive impact on performance, see AfDB 1999.

23. In a sense these high costs act as an export tax, increasing the costs of production over those of suppliers that do not pay these duties.

24. See various needs assessment papers issued through the Integrated Framework for Trade-Related Technical Assistance to Least Developed Countries process. They include references to the state of standards and conformity assessment systems and infrastructure needs in these countries (www.ldcs.org/index.htm).

25. Under tariff quotas, a fixed quantity of products from specified countries can be imported at a lower tariff and anything above that level is subject to the normal tariff.

26. The average most favored nation (MFN) tariff for these 311 lines is 21 percent; for the least developed countries it is 18 percent.

27. It is not clear why so few of these products are imported into Quad countries. But the significant difference between the United States' (86 percent) and the European Union's (9 percent) share of developing countries' exports suggest that intra-EU trade makes up the difference.

28. Note that GSP and North-South free trade arrangements imply some trade diversion that will benefit some developing countries, but hurt others. Forth-

coming work by Hoekman, Ng, and Olareaga (2000) argues that these preferences are not very extensive.

29. The NAFTA preference is 50 percent for these tariffs.

30. The producer support estimate (percent PSE) is calculated as the annual monetary value of production-related support to agricultural producers as a share of gross farms receipts (OECD 2000a).

31. The recent proposal by the EU to grant duty-free access to all exports from least developed countries and the move to income support rather than direct support to production should improve market access for developing countries.

32. UNCTAD (TDR 1999) has shown that in low- and medium-skill manufactures, small changes in import penetration ratios significantly increase the export growth rates for these products from developing countries.

33. Tariff escalation means that the tariff rate rises with the level of processing.

34. For example, developing countries' share in fruits and vegetables trade, which is less protected, has not declined over this period.

35. Previous sections described the impact of conflicts and trade-related policies on developing countries' performance. In addition, expansion of agricultural exports (such as tropical commodities) that are subject to few trade restrictions in industrial countries tends to reduce prices and hence the terms of trade.

36. The effect on agricultural exports is much greater. The model reduces the exports of other products that faced lower tariffs because of factors moving to the expanding agricultural sector.

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Annex 2.1 Sample countries in various charts and tables

No.	Region					Within core sample			
		All developing countries [105]	Countries in conflict [19]	ECA countries (excluding Yugoslavia) [6]	Core sample [59]	Least-developed countries [16]	Low-income small countries [22]	Countries with high REER volatility in 1990s [26]	Countries with low REER volatility in 1990s [33]
1	Africa	Angola	Angola						
2	Africa	Burundi	Burundi						
3	Africa	Benin			Benin	Benin	Benin		
4	Africa	Burkina Faso			Burkina Faso	Burkina Faso	Burkina Faso		
5	Africa	Botswana			Botswana				Botswana
6	Africa	Central African Republic			Central African Republic	Central African Republic	Central African Republic		
7	Africa	Côte d'Ivoire			Côte d'Ivoire		Côte d'Ivoire		
8	Africa	Cameroon			Cameroon		Cameroon		
9	Africa	Congo	Congo						
10	Africa	Comoros							
11	Africa	Cape Verde							
12	Africa	Djibouti							
13	Africa	Ethiopia	Ethiopia						
14	Africa	Gabon			Gabon		Gabon		
15	Africa	Ghana			Ghana	Ghana		Ghana	
16	Africa	Guinea							
17	Africa	Gambia			Gambia	Gambia		Gambia	
18	Africa	Guinea-Bissau							
19	Africa	Equatorial Guinea							
20	Africa	Kenya			Kenya	Kenya	Kenya		
21	Africa	Liberia	Liberia						
22	Africa	Lesotho							
23	Africa	Madagascar			Madagascar	Madagascar	Madagascar		
24	Africa	Mali			Mali	Mali	Mali		
25	Africa	Mauritania			Mauritania	Mauritania		Mauritania	
26	Africa	Mauritius			Mauritius			Mauritius	
27	Africa	Malawi			Malawi	Malawi	Malawi		
28	Africa	Namibia							
29	Africa	Niger			Niger	Niger	Niger		
30	Africa	Nigeria			Nigeria	Nigeria	Nigeria		
31	Africa	Rwanda	Rwanda						
32	Africa	Sudan							
33	Africa	Senegal			Senegal		Senegal		
34	Africa	Sierra Leone	Sierra Leone						
35	Africa	São Tomé & Príncipe							
36	Africa	Swaziland							
37	Africa	Seychelles Islands							
38	Africa	Chad			Chad	Chad	Chad		
39	Africa	Togo			Togo	Togo	Togo		
40	Africa	Tanzania			Tanzania	Tanzania		Tanzania	
41	Africa	Uganda	Uganda						
42	Africa	South Africa			South Africa			South Africa	
43	Africa	Democratic Republic of the Congo	Democratic Republic of the Congo						
44	Africa	Zambia			Zambia	Zambia	Zambia		
45	Africa	Zimbabwe			Zimbabwe		Zimbabwe		
46	East Asia	China			China			China	
47	East Asia	Fiji							
48	East Asia	Indonesia			Indonesia	Indonesia	Indonesia		

Annex 2.1 Sample countries in various charts and tables (continued)

No.	Region	All developing countries [105]	Countries in conflict [19]	ECA countries (excluding Yugoslavia) [6]	Core sample [59]	Within core sample			
						Least-developed countries [16]	Low-income small countries [22]	Countries with high REER volatility in 1990s [26]	Countries with low REER volatility in 1990s [33]
49	East Asia	Republic of Korea			Republic of Korea			Republic of Korea	
50	East Asia	Malaysia			Malaysia				Malaysia
51	East Asia	Philippines			Philippines				Philippines
52	East Asia	Papua New Guinea							
53	East Asia	Thailand			Thailand				Thailand
54	East Asia	Myanmar			Myanmar	Myanmar	Myanmar		Myanmar
55	ECA	Former Soviet Union		Former Soviet Union					
56	ECA	Bulgaria		Bulgaria					
57	ECA	Former Czechoslovakia		Former Czechoslovakia					
58	ECA	Hungary		Hungary					
59	ECA	Poland		Poland					
60	ECA	Romania		Romania					
61	ECA	Yugoslavia, federal Republic of (Serbia/Montenegro)	Yugoslavia federal Republic of (Serbia/Montenegro)						
62	LAC	Argentina			Argentina			Argentina	
63	LAC	Bolivia			Bolivia				Bolivia
64	LAC	Brazil			Brazil			Brazil	
65	LAC	Barbados							
66	LAC	Chile			Chile				Chile
67	LAC	Colombia			Colombia				Colombia
68	LAC	Costa Rica			Costa Rica				Costa Rica
69	LAC	Dominican Republic			Dominican Republic				Dominican Republic
70	LAC	Ecuador			Ecuador				Ecuador
71	LAC	Guatemala	Guatemala						
72	LAC	Guyana							
73	LAC	Honduras			Honduras			Honduras	
74	LAC	Haiti	Haiti						
75	LAC	Jamaica			Jamaica				Jamaica
76	LAC	Mexico			Mexico			Mexico	
77	LAC	Nicaragua	Nicaragua						
78	LAC	Panama							
79	LAC	Peru	Peru						
80	LAC	Paraguay			Paraguay				Paraguay
81	LAC	El Salvador	El Salvador						
82	LAC	Suriname							
83	LAC	Trinidad and Tobago							
84	LAC	Uruguay			Uruguay				Uruguay
85	LAC	Venezuela, Rep. Bol. de			Venezuela, Rep. Bol. de			Venezuela, Rep. Bol. de	
86	MNA	Turkey			Turkey				Turkey
87	MNA	United Arab Emirates							
88	MNA	Kuwait	Kuwait						
89	MNA	Morocco			Morocco				Morocco
90	MNA	Bahrain							
91	MNA	Algeria			Algeria			Algeria	

Annex 2.1 Sample countries in various charts and tables (continued)

No.	Region	All developing countries [105]	Countries in conflict [19]	ECA countries (excluding Yugoslavia) [6]	Core sample [59]	Within core sample			
						Least-developed countries [16]	Low-income small countries [22]	Countries with high REER volatility in 1990s [26]	Countries with low REER volatility in 1990s [33]
92	MNA	Egypt, Arab Rep. of			Egypt, Arab Rep. of				Egypt, Arab Rep. of
93	MNA	Iran, Islamic Rep. of			Iran, Islamic Rep. of			Iran, Islamic Rep. of	
94	MNA	Iraq	Iraq						
95	MNA	Jordan			Jordan				Jordan
96	MNA	Oman			Oman				Oman
97	MNA	Saudi Arabia			Saudi Arabia				Saudi Arabia
98	MNA	Syrian Arab Republic	Syrian Arab Republic						
99	MNA	Tunisia			Tunisia				Tunisia
100	MNA	Yemen, Rep. of	Yemen, Rep. of						
101	South Asia	Bangladesh			Bangladesh	Bangladesh	Bangladesh		Bangladesh
102	South Asia	India			India				India
103	South Asia	Sri Lanka			Sri Lanka		Sri Lanka		Sri Lanka
104	South Asia	Nepal			Nepal	Nepal	Nepal		Nepal
105	South Asia	Pakistan			Pakistan		Pakistan		Pakistan