

Chapter 8 Making Markets Work for the Poor

8.1 Markets have a profound impact on the well-being of the poor. Poor workers sell their labor to landlords or factory owners. Poor farmers sell their produce to traders. Informal sector markets are particularly important to women, who sell their labor or the output of small-scale activities. The demand for labor depends, in turn, on domestic and international markets for commodities. Access to credit markets determines the ability to invest—of the poor and of the nonpoor who hire the poor as workers.

8.2 The role of markets and state intervention in markets is a major issue in developing poverty reduction strategies. Over the past 20 years, there has been a tendency for national governments to reduce state intervention in markets, to replace public ownership with private ownership, and to replace protection with competition from foreign producers and investors. What effect have these changes had on the poor? What lessons have been learned from experience? What strategy should be adopted in the coming decade?

8.3 Market-oriented reforms have different effects on different groups within an economy. There are winners and losers, even among the poor, posing a dilemma for policymakers. What is to be done if a reform will increase growth and reduce poverty in the medium term but will hurt large numbers of poor people in the short term? One answer is to provide safety nets that minimize the short-term burden on the poor. These safety nets, discussed in detail in chapter 5, play an important role in the context of policy reform. Another answer, particularly if compensatory measures do not exist, is to regulate the pace of reform.

8.4 Much of the discussion—and much of the controversy—has centered on market-oriented reforms at the macro level. But markets, and state regulation of markets, affect poor people's lives at the micro level as well. The chapter presents evidence that micro-level deregulation—such as lifting the heavy hand of local bureaucracies on small-scale trading activities—can be greatly beneficial to the poor as they work to pull themselves out of poverty. In the coming decade, such reforms should receive much more attention than they have in the past.

From state intervention to market-oriented reforms

8.5 The past two decades have seen an unprecedented shift toward market-oriented reforms in the developing world. What sparked the widespread introduction of these reforms was the debt crisis of the 1980s and the collapse of communist regimes. Across Africa, Asia, and Latin America, the economic landscape has been significantly altered as countries have scaled back government involvement in economic activity, opened domestic markets to international trade and capital flows, revised tax codes, and sought to replace government determination of prices, output, and allocation of resources with market-determined outcomes. Since the fall of the Berlin Wall in 1989, virtually all

of the economies of Central and Eastern Europe and the former Soviet Union have joined in this shift. The fundamental objective of these reforms was to achieve macroeconomic stability and promote sustained economic growth. The belief was that removing policy biases against agriculture would accelerate the pace of poverty reduction, that reducing trade barriers and subsidies on capital would increase demand for low-skilled labor, contributing to broader-based growth.

8.6 Trade liberalization has been a central element of reform programs and the area in which most progress has been made in implementation. Tariff levels have been significantly reduced in several countries. The number and extent of coverage of quotas and nontariff barriers has also been scaled back considerably. In Latin America average tariff rates were reduced from 50 percent in 1985 to 10 percent in 1996 and maximum tariffs fell from an average of 83.7 percent to just 41 percent.¹ By 1996 nontariff barriers affected only 6.3 percent of imports, down from 37.6 percent before reform.² Developing countries have also undertaken significant liberalization of investment regulations in an effort to attract foreign investment. Another central element of reform was the reduction or elimination of a large assortment of subsidies in order to bring down fiscal deficits. As a result of privatization efforts,³ public enterprises have shrunk 10-15 percent in mixed economy developing countries and 30-40 percent in some transition countries over the past decade. Developing countries in Asia and Latin America have introduced extensive financial market liberalization, including capital account opening. Most African countries are less advanced in this area of reform. Labor market reform has generally featured much less prominently in most reform programs.⁴

8.7 In the medium term, reforms affect poverty primarily through three main channels: the rate of economic growth, the stability of growth, and the pattern of growth. The elasticity of poverty, as measured by the change in the headcount index with respect to changes in per capita income, is estimated to be between -1.5 and -3.5. The size of the effect is greater in countries in which income is more evenly distributed.⁵ The pattern of growth will determine how growth affects the poor. The poor will benefit if the pattern of growth boosts agriculture and promotes demand for low-skilled workers.

Reforms and growth

8.8 Primarily by removing barriers to access to new goods, technology, and investment opportunities (through trade, investment, and financial liberalization), reforms were expected to increase growth rates.⁶ Have they, in fact, done so? Reforms have

¹ Birdsall et al. 1998.

² IADB 1997.

³ Ramamurthi 1999.

⁴ Lindauer 1999.

⁵ Ravallion 1997.

⁶ One study, for example, finds that the removal of licenses and restrictions to import technology can greatly increase the speed of technological catch up (both in terms of use of and in terms of creation of technology) in a developing country. In turn, the speed with which income levels per capita conditionally converge with developed countries can also increase. Connolly 1999.

generally been associated with the end of economic decline and stagnation, and with some resumption of growth. According to one study,⁷ six countries in Africa that adopted reforms achieved a median increase in per capita GDP of two percentage points between 1981-86 and 1987-91. In contrast, in countries in which policies deteriorated, per capita GDP declined by 2.6 percentage points. Another study finds that reforms in Africa appear to have been successful in raising growth rates over a decade or so.⁸ In Latin America growth has returned to positive levels, and the decline in per capita income decline that began in the early 1980s has been halted. There is evidence that growth in the region would have been lower had the reforms of the past decade not been adopted (table 8.1). Moreover, growth was strongest where the greatest policy advances were made.⁹ One study finds that total factor productivity growth in Latin America was 1.5 percentage points a year higher on average during periods in which countries underwent reforms.¹⁰ In the transition economies of the former Soviet bloc, the countries that implemented reforms more forcefully and earlier have performed better.¹¹ A study of India finds that the reform-oriented states have grown fastest in the postreform period and that improvements in education and primary health care were also largest in states that adopted reforms.¹² Overall, the impact of reforms on growth appears to have been positive, albeit much more modest than anticipated. The growth rates attained are still lower than those required to achieve the goal of reducing the incidence of poverty by half by 2015 (see chapter 2).¹³

Table 8.1 Estimated changes in annual growth rates in Latin America as a result of reform

<i>Country</i>	<i>Easterly, Loayza, and Montiel estimates¹⁴ (1991-93 versus 1986-90)</i>	<i>Fernandez-Arias and Montiel¹⁵ (1991-95 versus 1986-90)</i>	<i>Lora and Barrera¹⁶ (1991-95 versus 1987-89)</i>
Argentina	6.3	3.1	4.0
Bolivia	3.3	0.9	1.9
Brazil	-0.3	1.4	2.2
Chile	0.9	0.3	0.3
Colombia	0.6	0.7	1.0
Costa Rica	0.7	1.2	0.8
Ecuador	0.3	2.2	3.8

⁷ World Bank 1994.

⁸ Rodrik 1997.

⁹ Lora and Barrera 1997, Fernandez-Arias and Montiel 1997 and Easterly et al 1997.

¹⁰ Fajnzylber and Lederman 1999.

¹¹ European Bank for Reconstruction and Development 1999, pp. 63-65..

¹² Bajpai and Sachs 1999.

¹³ Some authors argue that trade and capital market liberalizations have been associated with strong exchange rates and high interest rates, and that output and productivity growth have positive mutual feedbacks which liberalization may well suppress (Ocampo and Taylor 1998).

¹⁴ Easterly et al. 1997.

¹⁵ Fernandez-Arias and Montiel 1997.

¹⁶ Lora and Barrera 1997.

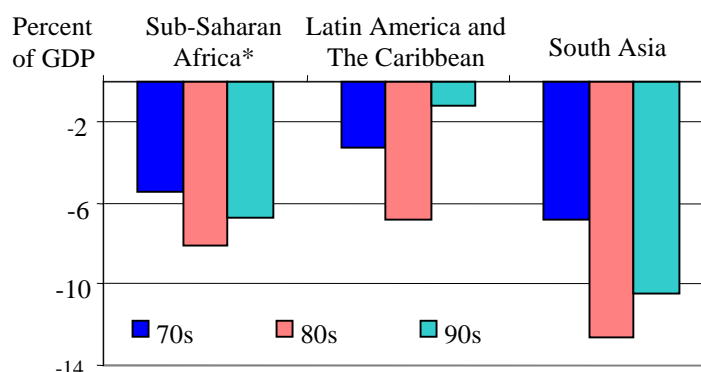
El Salvador	2.9	2.3	2.9
Guatemala	2.1	2.6	2.3
Honduras	1.4	2.1	1.4
Jamaica	–	1.8	0
Mexico	3.4	1.7	1.0
Paraguay	1.7	1.5	2.7
Peru	5.3	4.1	6.6
Trinidad and Tobago	–	2.8	2.1
Uruguay	1.4	0.8	1.2
Venezuela	1.3	1.5	2.1
Simple average	2.2	1.6	2.2
Weighted average	1.7	1.7	2.2

– Not available.

Source: IADB 1997.

8.9 Curbing the macroeconomic instability that results from imprudent fiscal and monetary policy leads not only to higher growth rates but fewer fiscally induced balance of payments crises and lower inflation. Across Africa, Asia, and Latin America, fiscal deficits have been significantly reduced (figure 8.1). As a result, inflation rates have fallen. In Latin America, for example, fiscal and monetary discipline reduced the average rate of inflation to 10 percent a year by the end of 1996, and only one Latin American country had annual inflation of more than 30 percent.

Figure 8.1 Fiscal balance by Region 1970s through 1990s.



Note: Figures exclude grants. Data for the 1990s include data through 1998. *Sub-Saharan Africa includes only countries covered in World Bank 1994.

Source: World Bank 1999.

8.10 High inflation can hurt poor people by reducing their cash balances and retarding growth, although the impact of the inflation tax on the poor may be overblown.

Going from hyperinflation to very low rates of inflation had a significant one-time effect on reducing poverty in Argentina, Bolivia, and Brazil. The link between inflation and poverty is less evident for moderate inflation rates, however. One study finds that the inflation tax did not affect those already below the poverty line in Latin America because of their negligible cash holdings.¹⁷ Another study finds that inflation and changes in poverty are inversely related but is not statistically significant.¹⁸ Although inflation does not appear to hurt poor people more than others, some authors find that the poor and very poor in developing countries are much more likely than other groups to mention inflation as a top concern.¹⁹

8.11 As for the effect of inflation on growth, the evidence confirms a strong and robust negative association between inflation and growth, but only at high rates of inflation—defined by some authors as 40 percent a year or more.²⁰ The effect of lower levels of inflation on growth is less clear. Bad macroeconomic policy affects growth through channels other than inflation. High fiscal deficits are strongly correlated with low growth.²¹ In Africa, for example, raising public savings by one percent can increase the growth rate from 0.11 percent to 0.27 percent.²²

8.12 Of all the reforms implemented, financial liberalization stands out for having caused serious disruptions in economic performance.²³ The combination of open capital accounts, weak regulation of the financial sector, and the volatility of short-term capital flows lie behind the major macroeconomic crises in the 1990s. The social costs of rescuing ailing financial institutions have been huge and regressive.

8.13 During the height of the “reform rush” the prevailing view was that reforms should be introduced as quickly as possible in order to take advantage of the “window of opportunity” provided by reform-friendly governments. This view is now changing. The financial crashes of the late 1990s in particular revealed the importance of creating adequate institutions (rules and organizations) and codes of behavior, or “social capital” (voluntary compliance with established laws, trust, cooperative behavior, and basic codes of conduct), before market-oriented reforms are adopted.²⁴

8.14 The short-term costs brought about by reforms to significant numbers of the poor has also triggered a more cautious approach to reforms. As we argue below, the creation of institutions to protect the poor from the short-term costs of reforms and ensure that the benefits of reforms reach the poor deserve as high a priority as creating independent central banks or adequate prudential regulations

¹⁷ Cardoso 1992.

¹⁸ Lustig and McLeod 1997.

¹⁹ Easterly and Fischer 1999.

²⁰ Bruno and Easterly 1998.

²¹ Easterly, Rodriguez and Schmidt-Hebbel 1994.

²² Rodrik 1997, tables 13 and 15.

²³ Bisat, Johnston and Sundararajan 1999.

²⁴ World Bank 1996b; World Bank 1997; EBRD 1999. An illustration of the renewed importance given to institutions is the fact that they will be the central topic of the World Development Report 2001/2.

Reforms and the pattern of growth

8.15 The recommendation of the 1990 World Development Report to adopt open trade policies and eliminate distortionary state interventions was based on the belief that market-oriented reforms would lead to broader-based growth than the protectionist and state interventionist development strategies that prevailed in most of the developing world. This view was supported by evidence that the East Asian economies, which had followed an outward-oriented growth path, grew faster and in a more equitable manner than Latin American economies, which faced recurrent macroeconomic crises and experienced only mediocre growth rates and persistent inequality. Since then, we have learnt that poverty reducing policy reforms involve much more (box 8.1).

Box 8.1 Poverty reducing policy reforms

1. There have been only a few cases of growth with equity, primarily in the Asian NICs. The equitable characteristic of their growth largely resided in the labor intensive nature of their productive sectors rather than redistribution. There were, however, expenditures on health education, and agriculture that were important. Public education was supplemented considerably by private education expenditures whose prerequisite is improved income.
2. Growth in Hong Kong (China), Korea, and Taiwan (China) was characterized by several features:
 - (a) a rapid growth of labor intensive manufacturing whose output was disproportionately directed to exports;
 - (b) within labor intensive sectors, socially appropriate wage-rental ratios encouraged the choice of techniques of production with low capital-intensity;
 - (c) foreign equipment and production methods were adapted and improved upon by well educated nationals;
 - (d) in countries without high education - Indonesia, Malaysia, Singapore, and Thailand -there was a heavy reliance on MNCs that substituted foreign for missing local skills.
 - (e) agricultural productivity was improved through adaptive local research and extension services and rural infrastructure was improved.
3. The combination of developments led to a rapid growth in rural productivity, raising agricultural incomes, and to the productive absorption in the urban sector of rural in-migrants and those previously employed in the urban informal sector.
4. The policy package and its results were:
 - (a) relatively free labor markets;
 - (b) a suppressed capital market that prevented conspicuous failures such as those that characterize many investments in other countries; real rates of interest were typically positive;
 - (c) most did not have particularly low tariff rates that militated in favor of pressures to minimize costs – incentives to be efficient came from pressures to export.
 - (d) Given the factor and product market incentives firms chose labor intensive industries and within them, labor intensive technologies. In several of the countries, particularly Hong Kong (China) and Taiwan (China), small scale enterprises were important sources of growth, dependent on a large entrepreneurial base.
 - (e) The informal sector did not play a major role and has declined very rapidly

5. The early growth spurt in several of the countries combined with the general sharing of benefits generated political legitimacy that allowed the governments to pursue policies that would not have been possible otherwise. Thus the response to the oil price increases in the 1970s was expenditure reduction and an increase in the real exchange rate. There were short term downturns but a rapid resumption of growth. Distribution affected the growth rate.
6. Are the conditions present that would allow a replication of this pattern in Sub-Saharan Africa, which along with South East Asia contains most of the poor?
 - a. There has been no “green revolution” and agricultural productivity remains low.
 - b. Industrial sector average and marginal product of labor has declined despite considerable investment. This implies that rural in-migrants cannot be absorbed in the urban sector.
 - c. While there is a robust informal sector, it is characterized by low productivity and thus low wages.
 - d. The small scale enterprise sector is very weak.
 - e. Korea like solutions have been tried. For example, Tanzanian manufacturing has large firms. They have had rates of growth of capital per worker not much different from those in East Asia yet their labor productivity declined by 40 percent over a fifteen year period.
7. Can Growth Resume?
 - a. Physical investment is not the magic bullet. Efficient use of existing capacity and maintaining it are more important.
 - b. While primary education is of importance, there is a need for a highly trained set of individuals to conduct agricultural research and to achieve greater productivity in the industrial sector. The highly skilled are needed to obtain increased returns for unskilled labor.
 - c. Liberalization of the trade regime has progressed. However, supply elasticities have been low, partly due to the shortage of high skills. Liberalization must be accompanied by efforts to improve the technological base of both rural and urban areas. Conversely, improving the latter without continued competitive pressures will not succeed.
 - d. Privatization is not a panacea. For example, the private sector in Tanzania is not much more efficient than the state owned sector.
 - e. Reliance on the informal sector or efforts to enforce subcontracting are unlikely to be successful.
 - f. Regional dispersion of industry to satisfy political constituencies should be discouraged as the potential for economies of agglomeration will be lost.
8. Policies
 - a. Greater stability in macro policy
 - b. A continuing decline in taxation of the agricultural sector
 - c. Greater emphasis on training a relatively small group of agronomists, engineers, and financial specialists
 - d. Encouragement of export oriented foreign direct investment
 - e. Improved maintenance of public infrastructure

These must be carried out simultaneously. Piecemeal reform may not work. For example, high education skills are particularly productive where the technology is changing. Much of changing technology is

introduced through imports. Hence without greater growth in imports, the marginal product of improved higher education will be limited.

Source: Excerpted from Pack 1999.

8.16 The view that removing trade barriers would result in low-skilled labor-intensive growth was also supported by the standard predictions of trade theory. Since developing countries have a comparative advantage in producing goods that depend on low-skilled labor, trade reform should lead to a decline in the relative price of skill-intensive goods. This would make the production of goods that use low-skilled labor more profitable, increasing the demand for (and wages of) low-skilled labor.

8.17 In fact, evidence shows that in the past 15 years the relative returns to skills have risen, not fallen. A number of studies find evidence that the returns to education have increased in Brazil, Colombia, Chile, Mexico, Thailand and Venezuela.²⁵ A study of Turkey finds that the premium on education for new entrants into the labor force has increased since 1987.²⁶ This pattern could be the result of supply and demand factors and changes in labor market institutions. The weakening of labor unions, for example, and reductions in the minimum wages during stabilization and reform periods could have altered the wage structure in developing countries. Given that in most countries the average years of schooling has risen and the distribution of education has improved, the observed upward change in the relative wages of skilled labor does not seem to be driven by supply factors. Rather, it appears that the demand for skilled labor must have risen faster than its supply.

8.18 There are two major explanations why this might have occurred: skill-biased technical change and trade liberalization. Some studies indicate that skill-biased technological change explains a large portion of the observed increase in the returns to skill.²⁷ Trade liberalization, however, appears to have played a role as well. A study of Mexico finds that the reduction in tariffs and the elimination in import license requirements can account for about one-fourth of the increase in the relative wages of skilled labor over the period 1986-90.²⁸ The authors explain this apparent anomaly by noting that despite its comparative advantage in low-skilled industry, Mexico protected its labor-intensive sectors before trade reforms were adopted. A similar result is found for Morocco.²⁹ At a more general level, one study³⁰ finds that openness³¹ is negatively

²⁵ The studies are by Ferreira and Paes de Barros 1999 in Brazil, Velez, Kugler and Bouillon 1999 in Colombia, Contreras, Bravo, Rau and Urzua 2000, Legovini, Bouillon and Lustig 1999 in Mexico, Bidani and Jong 1999 in Thailand, and Ruprah and Marcano 1999 in Venezuela.

²⁶ World Bank 1999.

²⁷ Robbins 1996; Harrison and Hanson 1999.

²⁸ Hanson and Harrison forthcoming.

²⁹ Currie and Harrison 1997.

³⁰ Lundberg and Squire 1999. The authors use the Sachs-Warner index to measure openness. Sachs and Warner define an economy as closed if it satisfies at least one of the following conditions: 1. Tariffs in the mid-1970's were 40 percent or more; 2. Quotas in the mid-1980's were 40 percent or more; 3. The black market premium (computed separately for the 1970s and 1980s) was 20 percent or higher in either the 1970s or 1980s; 4. The country had a state monopoly on major exports; 5. The country had a socialist economic system. An economy is defined as open if none of the above five conditions is satisfied. Sachs and Warner 1995.

correlated with income growth among the poorest 40 percent of the population but strongly and positively correlated with growth among higher-income groups. The costs of adjusting to trade reform are thus borne exclusively by the poor.³²

8.19 A study for Latin America finds that most reforms had a regressive impact on income distribution, but that this effect was small (box 8.2).³³ This it is not, however, a general result. A study for the countries in the former socialist bloc finds that in the countries that were more successful in implementing reforms, inequality increased very little and the opposite was true for the countries where reforms had been only partially introduced or did not reform at all.³⁴

³¹ Measured by the Sachs-Warner index.

³² Lundberg and Squire 1999. If, as Harrison and Hanson 1999 and Rodrik 1997 have suggested, the Sachs-Warner index should be interpreted as a measure of broad reforms rather than a measure of openness, these results suggest that broad reforms may be hurting the poor. Other studies suggest that this is not the case. A study of the former communist bloc countries finds that the more successful countries were at implementing reforms, the less inequality rose World Bank forthcoming.

³³ Morley 1999. Also, see Cornia 1999 and Stewart 1995.

³⁴ World Bank forthcoming. [cite as "Poverty and Inequality in Transition Economies", report by the Europe and Central Asia region.

Box 8.2 The impact of market reforms on inequality evidence from Latin America

Given historically high levels of inequality, the distributional effects have been a central element of the debate surrounding market liberalization in Latin America. CEPAL has completed a detailed study of the impact of market reforms in five areas including employment and equity. They find a regressive but small effect of reforms. Increasing the average reform index by 10 percent increases the Gini coefficient but only by a third of a percentage point. This confirms earlier work on the issue by Berry (1998) and Bulmer-Thomas (1996). The analysis however holds other things constant and ignores effects that could come through changes in the growth rate or in inflation due to reform. Individual reforms seem to have dramatically different and offsetting effects on equity and there are also differences in results between the countries for which there was only urban samples and those where the coverage was national.

	Urban sample	National sample
Privatization	Progressive	Regressive
Financial	Regressive	Regressive
Tax Reform	Regressive	Regressive
Trade reform	Regressive	Regressive
Capital Account Liberalization	Progressive	Progressive

Source: Morley 1999.

8.20 What can we conclude, then, about the relationship between trade openness and the ensuing demand for labor? The evidence does not confirm that greater openness has led to low-skilled labor-intensive growth—if anything, it suggests the opposite. Only time will tell whether the decline in the relative returns to low-skilled labor reflects a one-time adjustment effect or a bias toward higher skills. It may be that unilateral openness may not suffice to bring about pro-poor economic modernization. Deeper forms of economic integration, such as those encouraged by Japan in East Asia in the past thirty years or by trade agreements such as NAFTA, may deliver better results in terms of generating opportunities for low-skilled labor (box 8.3). At a more general level, this is consistent with the results presented by Quah (1997) on what can make countries which are in the low performance group move to the high performance club. The author finds that geographical proximity or intensive trade with a high performance country are key.

Box 8.3 Developing the local blue jeans industry in Mexico under NAFTA

NAFTA is transforming export production in Mexico by substituting traditional *maquila* production with a new and more integrated form of export manufacturing. Before NAFTA most Mexican exports to the United States were done under the 807/Maquila program. Raw materials and parts were transported from the United States to Mexico for assembly and then exported to the United States without taxation. The program was designed to allow the United States to take advantage of cheap Mexican labor without jeopardizing the future of U.S. producers. The *maquila* arrangement meant that U.S. companies invested relatively little capital in Mexico and created largely unskilled, low-wage jobs with no linkages to the local economy.

Liberalization of trade with the United States is pushing Mexico toward “full-package” production. In many industries, all manufacturing activities, including the purchase and production of raw materials, are now performed domestically. This full-package model increases opportunities for development by accelerating technology transfer, creating higher-quality jobs, and providing opportunities for local entrepreneurs.

NAFTA has gradually eliminated all barriers to trade in blue jeans, an important low-wage industry in Torreon and its surroundings in a state of northern Mexico. As a result, production activities in Mexico have expanded to cover laundering, cutting, and finishing as well as the use of raw materials. (Marketing and retailing, the most profitable activities in the industry, continue to be handled in the United States). Production volume rose from 500,000 pairs a week in 1993 to 4.5 million pairs in 1998, and full-package production has increased to about 25 percent of total output. Assembly prices have also risen—both because of higher demand for blue jeans and because higher-priced products are now being manufactured in the region.

Unlike the *maquilas*, this new mode of production has also created local linkages. Local producers of trims, labels, chemicals for laundering, and other jeans-related products now supply the industry. U.S. firms have introduced technological advances into the region, including automated sewing and assembly, computerized technologies for cutting, water recycling for laundering, and on-line inventory replenishment systems connected to U.S. clients. Although cheap labor continues to be an important reason why U.S. firms operate in Mexico, many large companies, including Wrangler, Kentucky-Lajat, and Cone-Parras, are making large investments in Mexico. Higher value added and profit margins, the addition of new activities, and the consequent increase in profits has also attracted Mexican entrepreneurs, including large diversified corporate groups. Their involvement in the industry is contributing to wealth retention.

Workers have been prime beneficiaries of trade liberalization. Employment in the Torreon area rose 30 percent between 1993 and 1998, and unemployment fell from 7.6 percent in February 1995 to 3.1 percent in December 1997. Moreover, a high (68 percent) share of new jobs created were manufacturing jobs. Wages remain far lower than in the United States, but they have been rising steadily since 1994, and the basic wage in the region is 1.5 times the minimum wage in Mexico. Productivity bonuses also allow workers to earn up to three times the minimum wage. Working conditions have improved, and although the power of unions has been reduced, workers use their ability to move from one company to another as a bargaining chip to obtain small wage increases and nonmonetary benefits. Employment opportunities created by NAFTA are also spreading to rural communities, as more companies establish plants in rural areas to escape higher-wage urban labor markets. Most jobs remain in urban areas, however, with only about 10 percent of apparel jobs located in rural communities.

Source: Gereffi and Martinez 1999.

8.21 Have market-oriented reforms increased agricultural growth? Under inward-oriented models, the structure of tariff and nontariff barriers and often the exchange rate were biased against agriculture. Eliminating the antiagricultural bias was an important component of the antipoverty strategy spelled out in the 1990 World Development Report. Reforms went beyond removing the antiagricultural bias, however, and included the dismantling of various forms of state intervention (price supports, subsidies to inputs and credit, storage facilities, support for marketing products, and so on). What is the evidence on the impact of reforms on agricultural performance?

8.22 An assessment undertaken by the World Bank shows that the impact of policy reforms such as trade, price, and market liberalization, and privatization, has been positive for a large number of policies and countries (table 8.2).³⁵ The impact has been most dramatic in Chile and China (box 8.4). However, where there was heavy agricultural protection, liberalization leads to contraction—accelerated movement of resources out of agriculture and reallocation within the sector to the more profitable crops. This was the case throughout the former Soviet bloc. The government heavily subsidized livestock and food-grain production to meet consumer demand of meat and dairy products, which was in turn stimulated because of consumer prices that held down

³⁵ This discussion is excerpted from Meerman 1997.

food prices. In these countries reforms in agriculture produced a painful blow out of the sector.

8.23 The elimination of directed credit was often not replaced by credit available in the free market. In some countries, financial reforms resulted in tighter credit and the closure of rural branches reducing credit availability. In other countries, credits were unavailable and costly due to government's macroeconomic policies and weaknesses in domestic banking systems.³⁶ Likewise, in some cases key services such as research, statistics gathering and reporting, and quality monitoring, disappeared after the abolition of parastatals. In Africa, for example, marketing boards tend to take functions in addition to marketing responsibilities. In Cameroon, for example, the marketing board was responsible for the maintenance of rural roads but the responsibility was not assigned elsewhere after reforms were introduced. Whenever the decline of the state has left an institutional vacuum, agricultural performance suffered. As with the rest of reforms, market liberalization without the proper institutional framework will not deliver the expected results and may have serious consequences for the poor as discussed below.

Box 8.4 Agriculture performance in Chile and China

Chile's experience provides dramatic illustration of cumulatively high agricultural supply response. After the military government took power in 1973, Chile began a sustained program of policy reforms. But the liberalization in prices and marketing and the privatization of production were associated with uncertainty about future agricultural policies. After the initial increase in production by one quarter in 1974, the medium-term producer response was decapitalization because of changing government policies. Many loans became nonperforming; total land in production dropped by more than one fifth; and many farmers lost land they had acquired through agrarian reform. From 1978-83, production stagnated because "the elimination of credit and input subsidies and appreciation in the real exchange rate during 1978-82 hit agriculture hard...Several delays—in eliminating price controls, implementing reforms in the land and water rights markets, and in labor market reforms—harmed agriculture...In 1984 the government aggressively devalued. As the result of earlier basic reforms...agriculture was ready for a vigorous recovery, which continues today" (Valdes 1994, 192). Not only has the sector responded very strongly, but agricultural labor-force participation took a most unusual turn—from a low of 14 percent it quickly rose to more than 19 percent of the total labor force, substantially higher than what it had been in the entire previous decade. Agricultural growth increased from 0.2 percent in 1960-74 to 4.9 percent in 1974-90. Increased productivity of land was a major factor. Despite the elimination of input subsidies, the national yield of wheat, the most important crop, increased from 1.7 tons/hectare in the late 1970s to 2.6 tons/hectare in the late 1980s. Similar increases occurred in maize and sugar beet yields. Labor-intensive horticulture was a minuscule sector before adjustment, but by the 1990s annual exports exceeded \$1 billion. Most policy analysts in Chile cite the changes in the real exchange rate as the main factor influencing the overall competitiveness of agriculture.

China's agricultural liberalization can be seen as the exception that tests or proves the rule. Why was supply response to price and production liberalization rapid rather than slow? Several factors are involved. China has good infrastructure in roads and irrigation, excellent technical packages for grains and other crops, and adequate production of fertilizer and other inputs. Once commerce was freed, competitive markets developed rapidly. The development of regional and national markets permitted rapid gains from trade as producers became convinced that the newly privatized land was truly theirs, which provided an additional incentive for long-term investment. In contrast, in Africa, for example, the cumulative impact of poor infrastructure, weak technical packages, slow development of commerce, and highly uncertain land tenure have substantially suppressed supply response to price and institutional liberalization.

³⁶ This discussion is excerpted from Akiyama and others, forthcoming.

China greatly increased its productive capacity between the 1940s' revolution and the 1970s. In rice, the Green Revolution was a reality. Irrigation capacity had more than doubled. There were very large increases in fertilizer production. Arable land per capita, however, declined from about 0.2 to 0.1 hectare over the same 30 years. State-imposed cropping patterns forced most cultivation into rice and other cereals. Collective farms were required to fulfill grain quotas for delivery to the cities, and the national grain market was fragmented into 30 self-sufficient regions. With this system, grain production in China kept pace with population growth up to the late 1970s. But by 1978, China had to import sufficient grain to supply about 40 percent of its urban population.

In 1979, the government initiated a series of sweeping agricultural reforms. These showed that the country had been far from its "production frontier," above all with respect to the productivity of labor. The first and foremost reform was the break-up of the communes and their replacement by family farming. Although initially farmers were still forced to deliver grain at low prices, they were otherwise permitted to produce what and as they wished at mostly market prices. Commerce within the rural areas and between farm and city, hitherto repressed by the state, was also allowed to flourish. Rather than self-sufficient provinces, the state encouraged the establishment of regional and national markets. Effective demand increased rapidly for high-value crops (vegetables, fruits, meat, fish, and eggs) that had been repressed by the earlier dirigiste policies. China's peasant farmers—skilled, hard working, and strongly motivated—responded to the new opportunities with great vigor and launched five years of the fastest sustained agricultural growth ever recorded anywhere in the world. Between 1978 and 1984 net agricultural output increased by 7.7 percent annually while that of grain grew by 4.8 percent (Lin 1995).

Source: Excerpted from Meerman 1997.

Table 8.2 Impact of reforms on agricultural prices, output and productivity in eight countries.

(percentage change, post-reform period of five years compared with pre-reform period of five years)

	Real agricultural prices	Real exchange rate ^a	Real GDP growth ^b	Agricultural output	Multifactor agricultural productivity growth
Chile	+120	+105	+28	+40	+8.2
Ghana	+5	+230	+3.9	+50	+12.2
Honduras	^c	+96	—	^c	^c
Hungary	-10	-23	—	-15	+25.4
Indonesia	+20	+75	-.6	+42	+2.3
Madagascar	+11	+94	+2.0	+15	+2.9
Mexico	-24	+22	-3.7	+14	+1.3 ^d
New Zealand	-31	-2	+.4	+5	+0.8

^a A "+" entry means the currency depreciated in real terms relative to the dollar.

^b The change in the annual growth rate is measured in percentage points, for example, an increase from 2.0 percent to 3.0 percent gets an entry of +1.0, not +50.

^c Reforms were too late to be assessed using the FAO database, but World Bank data indicate quite favorable developments in both real producer prices and in agricultural output during 1991-94.

^d Productivity growth was negative in the five years after reform but was even more negative in the five years before reform.

Source: Bruce Gardner 1995, 22.

The costs and benefits of reforms to the poor

8.24 Insofar as they contributed to higher—albeit only modest—growth rates, reforms appear to have been good for poverty reduction. However, this positive growth-effect is dampened by the fact that the impact of the reforms on income distribution might have been unequalizing. As we saw in the previous section, for example, openness has been associated with a deterioration in income growth for the poorest 40 percent.

8.25 Furthermore, grouping all poor people together conceals important differences in poverty outcomes across and within countries. It also conceals the fact that reforms can have very important short-term costs for the poor.³⁷ Ignoring or paying insufficient attention to the fact that important segments of the poor can be absolutely or relatively worse off as a result of reforms could jeopardize social cohesion, poverty reduction, and the sustainability and further progress of reforms. As argued in chapters 5 and 6, short-term shocks to living standards—including the short-term costs of reforms—can have irreversible effects on poor people's assets, particularly the human assets of their children.

8.26 We now focus on reforms that hurt the poor in order to create greater awareness of the burden some reforms place on the poor and to emphasize the need for policymakers to consider these costs in formulating policy. Acknowledging the fact that reforms may hurt the poor (or even create new poor) has several implications. First, before introducing reforms, policymakers should assess how the reforms will affect the poor, both in aggregate terms and by subgroups. Second, on the basis of such an assessment, policymakers should determine whether the reforms (or the way in which they are implemented) can be modified to reduce the costs to the poor without sacrificing much efficiency. Trade liberalization for low-skilled labor-intensive goods could be phased in more slowly, for example, or certain consumer goods, such as food staples and medicine, exempted from the value-added tax. Third, policymakers should put in place safety nets, such as employment programs, to help poor people cope with reforms.

8.27 Evidence from a study of six African countries highlights how different groups fared differently under reforms. Poverty was more likely to decline in countries that improved their macroeconomic balances than in those that did not. But the evidence also shows that in three countries—Kenya, Nigeria, and Tanzania—real spending by the poorest segment of the population declined, even though the incidence of poverty fell nationwide. The decline in spending was particularly marked in Tanzania, where the poorest 10 percent were worse off in 1991 than they were in 1983. In Kenya the incidence of hard core poverty³⁸ increased by four percentage points. In Nigeria, where overall poverty declined markedly, the incidence of hard core poverty rose 2.5 percentage points between 1985 and 1992. These results highlight how grouping the poor together

³⁷ Pioneer work on this was presented in Cornia, Jolly and Stewart 1987.

³⁸ Based on a poverty line that defines approximately 10 percent of the relevant population as poor in the base year. This line is kept constant in real terms in estimating the incidence in the terminal year.

as a homogeneous group can conceal the fact that the incomes of some poor people can decline, even when the living standards of the poor as a whole rise.³⁹

8.28 There is no question that very high inflation is bad for the poor and that macroeconomic stability is a prerequisite for sustained and stable growth. The question is how macroeconomic stability is achieved and at what cost to the poor. One key concern about stabilization programs based on massive public spending cuts or sharp interest rate spikes is that they can induce larger contractions of output in the short run than more gradual approaches. As noted in chapter 6, the poor may prefer a more gradual approach to stabilization. But as we argued earlier, pro-poor policymakers can choose the policy that is optimal for the economy as a whole, while protecting the poor through safety net programs. Although this could be done, the evidence suggests that programs to protect the poor are not safeguarded during adjustment. In Mexico, for example, during the 1980s crisis, one of the few programs that served the rural poor was eliminated.⁴⁰ In Argentina programs that were more finely targeted to the poor were cut disproportionately in the 1990s.⁴¹

8.29 Removal of price subsidies—particularly for food and social services—and introduction of market prices and user fees as part of fiscal tightening can adversely affect the poor. As discussed in chapter 7, there is some evidence that the introduction of user fees in health hurt the poor more than the rich. A study of Guinea, Madagascar, and Mozambique found that elimination of food subsidies did not hurt the poor because the subsidies had not targeted the poor. In Madagascar, however, the incomes of poor households in the capital declined substantially when food prices were decontrolled.⁴²

8.30 In the 1990s governments in Central and Eastern Europe and in the former Soviet Union introduced a rapid phase-out of across-the-board utility subsidies in all countries in the region. The urgency was dictated by the need to reduce unsustainable fiscal deficits. The change had a potentially huge impact on the welfare of families, including the poor. In Ukraine, for example, household energy tariffs increased four- to twelvefold (in real terms) between 1992 and 1995, while average household income dropped to less than half its prereform level. In Moldova the average winter heating bill would have exceeded 60 percent of the (cash plus in-kind) income of a typical family of four in the lowest income quintile living in a small apartment. Aware that this situation was unsustainable, the government introduced a number of mechanisms to subsidize families, ranging from tolerance of nonpayment to establishment of differential tariff rates.⁴³

8.31 Revenue raising measures, such as replacing other taxes with value-added taxes, can also hurt the poor. Evidence from Ghana suggests that as a percent of spending, the increased tax burden has been smaller for the poor than for better off households. Together with other groups, however, the poor paid more taxes after the new

³⁹ Demery and Squire 1996.

⁴⁰ Lustig 1998.

⁴¹ Ravallion 1999.

⁴² Sahn et al. 1997.

⁴³ World Bank 2000.

measures were introduced.⁴⁴ In Pakistan the lowest income groups not only had to pay more taxes but they experienced a larger increase in their tax burden relative to their incomes than the highest income groups (table 8.3). While the tax burden on the richest income group declined 4.3 percent, the tax burden on the poorest group rose 10.3 percent.

8.32 Reforms in Madagascar seem to have hurt the rural poor despite the increase in their output. Following reform, agriculture grew the fastest it had in 20 years (albeit still at a modest rate), with growth concentrated among the smallest farmers. But the evidence also shows deepening poverty during and following liberalization, particularly in rural areas. Nutritional, educational, and spending data all suggest significant deterioration in living standards among the country's primarily rural poor. An important cause appears to be the significant liberalization-induced rise in the mean and variance of all major food crop prices, particularly rice. Rice price changes associated with liberalization are estimated to have led to welfare losses of more than 20 percent for more than a third of the country's rice farmers, who comprise most of the country's poor.⁴⁵ Because most small farmers in Madagascar are net rice buyers, liberalization seems to have induced significant welfare losses among the country's primarily rural poor, including a large proportion of rice producers. A natural response for immiserized smallholders is to increase their labor effort, which increases output. Hence the apparent paradoxical result of higher agricultural output and higher rural poverty.⁴⁶

8.33 In Zambia liberalization of the price of maize led to a deterioration of living conditions of small farmers living in remote areas. Under the old policy regime, farmers in remote areas were subsidized by those close to rail lines through pan-territorial pricing, small farmers were subsidized by larger farmers with storage facilities through pan-seasonal pricing, and the agricultural sector as a whole was subsidized by mining. All of these subsidies were removed and, as a result, farmers in remote areas are unambiguously worse off—and their situation is substantially worse than it would have been solely as a result of the removal of pan-territorial pricing. For them, functioning markets have largely disappeared. Before reforms, purchases were made by a monopsonistic parastatal buyer; since reforms were introduced, there is often no buyer at all or prices are extremely low.⁴⁷ In addition, because pan-seasonal pricing disrupts markets for storage, governments pursuing such policies tend to own the storage facilities. When markets are liberalized, storage markets are underdeveloped, exacerbating seasonal and spatial price volatility.

⁴⁴ Younger 1996.

⁴⁵ Barrett and Dorosh, 1996.

⁴⁶ Barrett 1998.

⁴⁷ Winters 1999.

Table 8.3 Changes in tax incidence across income groups in Pakistan, 1987/88–1990/91

Income groups (Rs. per month)	Increase in tax burden as a percentage of income
Up to 600	10.3
601-700	6.8
701-900	4.7
901-1,000	4.4
1,001-1,500	3.0
1,501-2,000	2.3
2,001-2,500	1.8
2,501-3,000	0.9
3,001-3,500	1.5
3,501-4,000	0.2
4,001-4,500	2.4
More than 4,500	-4.3

Note: Includes income tax, tariffs, excise duties, and sales tax.

Source: Kemal 1994.

8.34 As a result of trade liberalization in Guinea between 1987 and 1992, the volume of rice imports more than doubled, increasing food consumption and food energy uptake. However, the incomes of local rice producers, most of whom were poor, declined. While the welfare benefits were estimated to exceed the real income cost from decreased production, the private costs for individual farmers, most of whom were poor, were significant.⁴⁸

8.35 The dismantling of the International Coffee Agreement and liberalization measures in Mexico resulted in a very sharp drop in coffee prices there. Between 1986 and 1992 prices plummeted from an average of \$1.32 a pound to \$0.53 a pound. Among the hardest hit were producers in indigenous communities, who constituted 65 percent of all of Mexico's producers and produced a third of Mexico's coffee output.⁴⁹ The decline in coffee prices may be one of the factors behind the sharp increase in extreme poverty in the southeastern region (which includes Chiapas), where the incidence of poverty rose from 16 percent in 1984 to 47 percent in 1992.⁵⁰

⁴⁸ Arulpragasam and Ninno 1996.

⁴⁹ World Bank 1996.

⁵⁰ Lustig and Szekely 1997.

8.36 These examples reveal that poor people can be hurt by reforms. It is little wonder, then, that in many civil society forums one hears voices of discontent about reform.⁵¹ Policymakers and international financial institutions should listen to what stakeholders of reforms have to say rather than pursuing top-down approaches that are often insensitive to the complaints of those who lose out (box 8.5). Participation in decisionmaking and the right to make informed choices are an intrinsic element of the poverty reduction strategy proposed in this report. This approach can also help ensure that the benefits of reforms reach the poor.

Box 8.5 Listening to farmers in Zambia

Since 1991 Zambia has made radical changes to the policy and institutional environment governing its agriculture sector. Liberalization and privatization have replaced state-supplied agricultural services (credit, input supply, and agricultural marketing) with private sector provision.

Under a World Bank–assisted Agricultural Sector Investment Program, systematic and regular feedback between policymakers and service providers and those affected by programs has been established, using methods such as participatory rural appraisals and beneficiary assessments. Talking to farmers has helped policymakers understand farmers’ resource constraints, service delivery problems, and strategies for dealing with the vicissitudes of transition. Participatory assessments also examine local perceptions of the effectiveness of agricultural infrastructure and services, including credit, input supply, agricultural marketing, and extension.

The results of these consultations revealed that agricultural credit and marketing, which are now handled by the private sector, has been uneven and unpredictable, because of poor infrastructure, lack of capacity, and inadequate enforcement mechanisms. Public services such as agricultural extension and animal health have suffered from staff shortages and lack of operating funds, transportation, and equipment, and they have failed to respond well to farmers’ needs. Some private sector extension appear to be performing well.

To deal with the problems they face, farmers adopt a variety of strategies. These include reverting to subsistence crops and traditional cropping systems; diversifying crops and adopting drought-resistant crops, such as cotton and cassava; increasing their reliance on nonfarm sources of income, such as hunting, fishing, and casual labor; reducing consumption by eating fewer meals per day and relying on foodstuffs collected in the wild; and selling off assets, such as draft animals.

These findings have led to recommendations for improving the quality and equity of services used by small farmers. Farmers want improved infrastructure (especially roads and bridges) and effective regulation of the private sector. They seek more information on markets for agricultural produce and access to more flexible and responsive credit facilities. They prefer group extension methods and want advice on subsistence crops and storage methods.

Talking to farmers has revealed means of building the capacity of remote and economically vulnerable farmers to participate in agricultural markets. Possible mechanisms include promoting local seed production systems, extending microcredit, and offering research and extension directed at subsistence crops and low-input agriculture. To create the local organizational basis needed for participatory extension and for economically viable joint activities, such as marketing, local-level financial services, and cattle dipping, support needs to be given to producer associations, service-providing NGOs, and other organizations active at the community level.

Source: World Bank 1998.

8.37 Economic reforms can also bring direct and visible benefits to the poor. Liberalization has improved outcomes in Zimbabwe’s cotton sector with benefits for smallholders. Before the reforms, the Cotton Marketing Board used its monopsony to

⁵¹ SAPRIN 1999.

impose low producer prices on farmers in order inter alia to subsidize the textile industry. In absolute terms, the first order effects will have been greater for larger farmers, simply because they produced more cotton. But ultimately it probably affected smaller farmers most severely because they lacked the large farms' ability to diversify into other crops such as horticulture.⁵²

8.38 Following deregulation and privatization, there is now substantial competition between three buyers, one of which is owned by farmers themselves. Again, in absolute terms this must have benefited larger farmers more than small ones, but there have been particular gains for the smallholders. These have included the fact that the buyers have chosen to compete with each other not only on price (which has increased significantly), but also by providing extension and input services to smallholders. While the latter are obviously reflected in the prices that the farmers receive, their provision fills a gap that would otherwise exist in small farmers' access to inputs (including, in this case, information). Hence, the changes have assisted small farmers both through an increase in price and by enabling them to produce more.⁵³

8.39 In Bangladesh, the removal of anti-export bias, introduction of export-promotion incentives and the pursuance of export-led growth strategy over the last decade have resulted in rapid and robust growth of industries such as ready-made garments (RMG) and shrimp production. Over the last decade the RMG sector grew at a rate of 15 percent annually and accounted for almost 90 percent of the incremental exports of the country. The shrimp sector grew at 12 percent over the same period. Increased investment in such sectors subsequently led to a substantial increase in the number employed in the export-oriented industries. The RMG sector alone has been able to provide employment to about 1.3 million workers in recent years. The key beneficiaries of this expansion have been women who form 80 percent of employment in this sector.⁵⁴ For most of these women this has provided their first opportunity for paid work.

8.40 We have seen in Chapter 7 that in rural areas, access to land can be a key for poverty reduction. Improved access to land, accompanied by access to other assets such as credit and infrastructure, can improve land and labor productivity of the poor. Preliminary results of land market liberalization in Mexico indicate that small farmers have been able to expand their access to land through the rental market (box 8.6).

Box 8.6 Land market liberalization and the poor in Mexico (1994-97)

Liberalization of land rentals and the reorganization of the property rights system in the *ejidos* in 1992 were the backbone of a series of structural reforms that have transformed the Mexican economy. It was anticipated that by liberalizing land markets and better defining and enforcing land property rights, costs of transacting in both land and credit markets would be drastically reduced, thereby improving access to land and credit by poor, small-scale (and perhaps more efficient) producers.

Under equal access to credit, policies aimed at activating land rental markets would benefit the landless and the land-poor by increasing their access to land through rental and sharecropping transactions.

⁵² Winters 1999.

⁵³ Winters 1999.

⁵⁴ Winters 1999.

However, with combined land and credit market liberalization reforms, the effects of a less restricted land rental market could be offset by a reduction in the access to credit of the land-poor, causing a shift from smaller to larger holders.

The empirical evidence suggests that the combination of land market liberalization and a more than proportional drop in access to credit for large farmers following the 1995 financial crisis, have induced an increased supply of land by the latter to the rental market. This has allowed a small but statistically significant increase in access to land by the rural poor via the rental market. Controlling for access to credit, it appears that large farmers have in fact increased their demand for land rentals. Nevertheless, the analysis suggests that once access for credit has been controlled for, small farmers appear to have increased their demand for land even further, suggesting that perhaps in the absence of the widespread fall in access to credit, land-poor farmers would have benefited even further from land market liberalization.

Source: Olinto, Davis, and Deininger 1999.

Reforming markets for the poor

8.41 To share in the benefits of reform, the poor must have access to markets, in both the physical and economic sense. The effect of liberalization of prices on poor households depends on the extent to which price changes are transmitted to poor producers. If internal markets for distribution are not competitive, liberalized prices will not affect the prices of goods farmers sell, and poor farmers will not benefit from the process. If credit markets do not function or infrastructure is inadequate, poor farmers will not be able to respond to a liberalized price environment by increasing their supply significantly. To reach the poor, many reforms need to be accompanied by institutional support, investment in infrastructure, and complementary reforms at the micro level. Regulations, which often lead to opportunities for corruption, can block access of the poor to markets or increase the cost of participating (box 8.7).

Box 8.7 Paying bribes to survive: corruption in the informal sector

A very large share of poor people work in the informal sector, where competition is intense and protections are few. A key challenge is staying ahead of public authorities and well-organized criminals who aim to shut them down, intimidate them, or extort money from them. These problems disproportionately affect poor women, who operate most informal sector businesses.

In Dimitrovgrad, Bulgaria, an important source of livelihood for women is sewing pants and bed sheets and selling them at the Sunday market. Women in the village complain, however, that they must pay 150,000 *leva* to rent a market stall, even though the official fee is less than half that.

In Eastern Europe and Central Asia many women are now engaged in transporting goods long distances and sometimes even abroad because they are less susceptible than men to being targeted by authorities and “the Mafia.” Small businessmen in Georgia report that they must pay bribes to both officials and organized crime groups. According to them, the only way to survive is to have a *krysha* (protector), to establish good relations with powerful figures in the police force, and to make one’s contacts well known in order to protect oneself from “sudden accidents.” In Cameroon traders in food crops reveal that “travel is a real nightmare.” Even when road conditions are good, travel is difficult because of road blocks, police harassment, and customs check points.

Owners of coffee and tea shops reported similar stories. A 49-year-old coffee shop owner from Varna, Bulgaria, revealed that the sanitary authorities harassed her until she paid them a bribe. The owner of a tea shop in Patna, India, indicated that he had to pay “taxes” to keep his business at the railway station open and that officials frequently demand free drinks.

Source: Narayan and others 2000; Narayan and others (forthcoming).

8.42 As we have seen in chapter 7, the poor tend to rely heavily on common property resources, because of their limited access to other types of assets. But the poor are often excluded from using these resources because of licensing, leasing, and other administrative regulations that benefit larger enterprises and better-off groups. In Indonesia, a village in Jambi applied for authority to manage its richly endowed caves as an enterprise after the license of a private company came to an end. The forest officials turned down the request because the community committee did not have nor could it acquire: evidence of registration as a company and an operating license to establish a work place. Forestry officials say that only a legally established company owned by individuals could exploit the cave. Removing these constraints as part of broader liberalization efforts, could be critical to the livelihoods of some poor groups (box 8.8).

Box 8.8 Raising incomes of village households by removing licensing regulations in Gujarat, India

Collecting gum from trees is the main source of livelihood in some villages in the Banaskantha area of Gujarat, India. Because gum is a nationalized product, however, villagers cannot legally collect gum without a license from the Gujarat State Forest Development Corporation.

The Self-Employed Women's Association organized women into collector groups and obtained licenses for them. The women earned Rs. 10 a kilogram instead of the Rs. 4 they received by selling gum to traders, who sold the gum to the state. Because these women were not allowed to participate in the open market for gum, however, and still had to sell to middlemen, they received only a fraction of market price of their goods. Between 1992 and 1996, the prices women received fell from Rs. 10 to as low as Rs. 6 a kilo, while open market prices peaked at Rs. 40 a kilo. As a result, living conditions worsened for these women and their families, as average household earnings dropped from Rs. 25 to Rs. 12 a day. An estimated 70 percent of families mortgaged their land, and 63 percent sold their land. More than 75 percent of families had children, many of whom were taken out of school in order to collect gum. Removing the requirement for licenses and allowing these women to sell directly in the open market would vastly improve their living conditions.⁵⁵

Source: Self Employed Women's Association 1997.

8.43 In order for Filipino corn farmers to benefit from developments in the corn market, they need to receive complete and timely information on corn prices. For this a number of initiatives should be taken.⁵⁶ Inter-island shipping vessels should be improved and roads upgraded to reduce the high cost of transportation. Better storage and marketing facilities should be established on farms and in towns and villages so that farmers can store corn rather than dumping it on the market immediately after harvest. Improvements in collecting and disseminating market information could make prices more transparent and improve the ability of farmers and traders alike to read price signals accurately and make correct marketing decisions. In another example, high transportation and storage costs attenuated price changes of potatoes following liberalization in Peru.⁵⁷

⁵⁵ Self Employed Women's Association 1997.

⁵⁶ Sebello Mendoza and Rosegrant 1995.

⁵⁷ Glewwe and de Tray 1989.

8.44 In low-income countries, microenterprises and small-scale enterprises typically comprise the vast majority of firms and account for a large share of employment.⁵⁸ In Bolivia, for example, firms with fewer than 10 employees represented close to 90 percent of the total number of firms in 1992.⁵⁹ Ensuring that small and micro enterprises are able to respond to and benefit from market liberalization is therefore critical for realizing the potential benefits for employment and for poverty reduction.

8.45 For this potential to be realized, additional micro-level reforms are needed to ensure that the poor can take advantage of opportunities created by market liberalization. These measures would focus primarily on increasing poor people's access to markets for the goods and services they produce, for their inputs, and for a diverse range of services that support their growth and competitiveness. Specifically, public policy should address the market failures that create cost disadvantages for small scale enterprises and micro enterprises, restrict their access to markets, and inhibit the development of markets for services, including credit, that small firms need. Public policies and regulations that increase fixed costs and thus create a competitive disadvantage for small firms should be reviewed and eliminated if the social costs exceed the benefits. In other cases, the policies should be applied flexibly to ease the burden on small enterprises.

8.46 In Chile, for example, the government recently simplified the duty drawback system to reduce the burden of administrative costs on small firms. In Bolivia parts of the tax system were drastically simplified for small firms.⁶⁰ In the Philippines, the minimum capital requirement for commercial banks is Ps. 2 billion (\$76.3 million), but thrift and rural banks can be set up with much less capital (Ps. 40–250 million for thrift banks and Ps. 2–20 million for rural banks). These institutions are permitted to provide the full range of deposit services, although they are more restricted in their other operations than commercial banks. This policy environment has facilitated the establishment of a large number of small banks. The cooperative rural banks in particular are known to have good capacity to provide microfinance services profitably.⁶¹

8.47 In contrast, in Indonesia official and unofficial levies are estimated to raise the costs faced by small and medium-size enterprises by as much as 30 percent.⁶² In some sectors, small enterprises have to secure as many as eight licenses—some of which have identical functions but are issued by different agencies—to become established. Procedures for obtaining licenses are so long and complicated that some business owners choose to operate illegally.⁶³ Reforms to reduce levies and simplify and shorten licensing and entry procedures for small and medium-size enterprises could ease this burden.

8.48 Even in infrastructure industries normally thought of as favoring natural monopolies, small and medium-size enterprises may be able to serve some segments of

⁵⁸ Hallberg 1999.

⁵⁹ Hallberg 1999.

⁶⁰ Hallberg, 1999.

⁶¹ McGuire et. al., 1998.

⁶² Hallberg, 1999.

⁶³ Asia Foundation and AKATIGA, 1999.

the market. In many urban areas in Africa and Latin America, for example, small independent water providers bring basic water services to marginal poor communities. Until recently, hundreds of small water companies competed in Paraguay (box 8.9). Small and medium-size enterprises have also been effective in solid waste management.⁶⁴ These enterprises often face barriers, however, such as requirements for experience, complex or expensive registration and tendering procedures, and noncompetitive behavior in markets. Removing these constraints could allow small and medium enterprises expand their activities in this area, increasing employment opportunities for lower income groups, while promoting expanded access to services for poorer communities.

Box 8.9 Eliminating competition in the water sector in Paraguay

In Paraguay, there are an estimated 500 small competing water companies. These *aguateros* have developed low cost technologies which provide a higher quality water at about one tenth of the cost of the public company serving Asuncion. In order to turn the public company over to a private concession as a regulated monopoly, the Congress has just passed a law which will confiscate all investments of *aguateros*. If it passes the final hearing in February, the law will lead to a monopoly, subsidized in a 30 year concession to a company formed by Lyonnaise des Eaux and a local investor. The *aguateros*, who have paid 100 percent for their networks, may be able to obtain 10 year renewable operating contracts but will now be reassigned to areas considered "rational" by the regulating agencies. This change will hurt lower income groups both through loss of jobs as *aguateros* fold up or reduce operations, through reduced access to water and possibly higher prices of water. Clearly this new law goes counter to the idea of liberalizing for the poor.

Source: Solo 1998.

⁶⁴ Haan et al 1998.

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