# Trade Liberalisation and Poverty

**by**

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February 2000

This paper is an output from a project funded by the UK Department for International Development (DfID) for the benefit of developing countries. The views expressed are not necessarily those of DfID. I am grateful to Xavier Cirera for research assistance, Shoshana Ormonde for logistical help and to Tricia Feeney, Subir Gokarn, Caroline Lequesne, Michael Lipton, Andrew McKay, Neil McCulloch, Pradeep Mehta, Chris Stevens, Howard White, and Adrian Wood, and participants in the World Bank's meeting on 'Openness, Macroeconomic Crises and Poverty' Kuala Lampur, May 10-12th 1999 for comments and advice.

# Trade Liberalisation and Poverty

## 1. Background

Openness and trade liberalisation have been a major component of conventional economic policy advice for the last fifteen years. Their advocates identify strong benefits from them in terms of both resource allocation and economic growth. While there remain some critics of such policies, there is widespread acceptance that in the long run open economies fare better in aggregate than do closed ones, and that relatively open policies contribute to long-run development. Many commentators fear, however, that in the shorter run trade liberalisation puts great stress on certain actors in the economy and that even in the longer run successful open regimes may leave some behind in poverty. Others additionally argue that being open – rather than just the process of opening up – exposes an economy to shocks that generate uncertainty, causes it to operate with higher levels of poverty than would a closed economy and undermines policy measures designed to alleviate poverty and redistribute income.

This paper summarises a project supported by the Department for International Development, UK designed to take these concerns seriously. This project asks how trade liberalisation impinges on poverty from a theoretical perspective (Winters, 2000a), from a grass-roots perspective in two African countries (Oxfam-IDS, 1999), from an econometric and labour market perspective (CUTS, 1999) and on the basis of the, surprisingly patchy, existing literature (McKay, Milner, Kedir and Franco, 1999). It considers briefly the appropriate policy response to fears of liberalisation-induced poverty and the dimensions of future trade negotiations that may raise poverty issues. It concludes that, while care is required to minimise poverty impacts (care that has not always been taken in the past), open trade is generally an important component of development policy, and one which can play a positive role in poverty alleviation.

If trade liberalisation and poverty were both easily measured, and if there were many historical instances in which liberalisation could be identified as the main economic shock, it would be simple to derive simple empirical regularities linking the two. Unfortunately, none of these conditions is met, and so we are thrown back on fragmentary evidence on parts of the argument[1]. Inevitably, then this paper is not able to lay the controversy that surrounds this issue to rest.

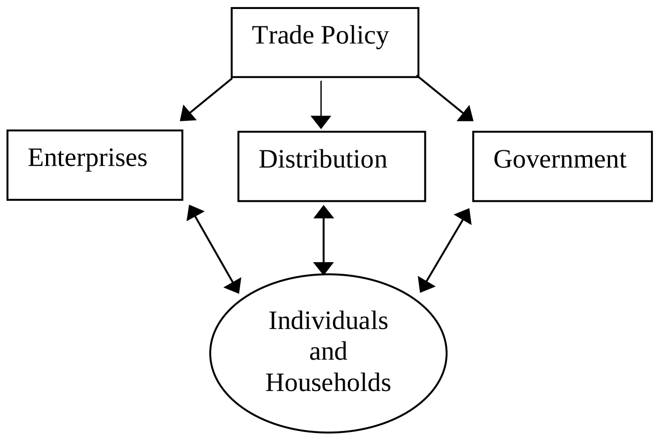
One of the reasons for controversy is that there are many reasons why people are poor, and thus the effects of any shock will differ across 'the poor'. A critical part of any debate must be to be clear about whom you are speaking. Another problem is identifying trade (or any other) liberalisation. Clearly it is actual not nominal market access that matters, and the two can differ significantly.

[1] For example, the fact that trade liberalisation in South-East Asia was associated with great strides in alleviating poverty is not sufficient to show that it caused those strides; too much else was going on. Similarly, the (mixed) evidence that liberalisation has gone with increasing poverty in Latin America since 1980 is not sufficient to prove the opposite.

## 2. The Causal Links

This section, based on Winters (2000a), sketches the main channels through which trade shocks, including trade liberalisation, are transmitted into poverty impacts. It provides a conceptual framework for interpreting the evidence of later sections and for thinking about policy implications. Trade shocks involve changes to the prices of tradable goods and we consider their effect on poverty by plotting how these work their way through to the things that affect household/individual welfare.[2] We will explore the static effects of trade policy on poverty via four groups of institutions, schematically arranged in figure 1, and then deal with economic growth and technology; and, finally, adjustment stresses.

**Figure 1: The Analytical Scheme**




### *2.1 Households*

The most useful notion of the household for thinking about the poor is the so-called ‘farm household’, which potentially undertakes production – e.g. producing subsistence crops or sorting garbage - as well as consumption. As a first order approximation, the effect of a price change on household welfare is proportionate to its net supply position (expressed at current prices as a proportion of total expenditure); price increases of things of which it is a net seller improve its welfare. These ‘things’ can be goods, services or factor services such as land use or labour and some will not be traded outside the household – e.g. labour for subsistence agriculture. Particularly in the case of external jobs, which are often available only for discrete units of time, changes may be discontinuous and will have the characteristics of quantity constraints. Household’s responses are also important: they affect the extent to which welfare shocks can be mitigated and the extent to which shocks in one market are transmitted to others and hence onto other individuals/households

[2] Strictly speaking, some shocks may entail quantity constraints – e.g. not being able to sell any more sugar to the USA at any price – but these are best considered once the basic price approach is in place.

A key extension of the household approach is to recognise the importance of intra-household distribution. It is not always realistic to assume that the welfare of each individual in the household changes proportionately to that of the whole. For example, subsistence requirements or culture may preclude the intra-household transfers that would be needed to compensate individuals who, because of their non-transferable endowments (labour), bear the brunt of external shocks. The distinction between "male" and "female" crops or activities is an important link here. So too are the arguments that falling male wages and/or employment can reduce female welfare because females are obliged to increase their work outside the home, but receive little compensatory help with their traditional in-home activities. Clearly the same effects could arise if the outside price of female labour rose - e.g. because of improved export prospects for clothing. If pressure on female labour for cash crops reduces women's input to the family food crops, nutritional standards could also suffer: fieldwork on the DfID programme discovered some evidence of these kinds of problems in Southern Province, Zambia.[3]

## *2.2 Distribution Channels*

Even in simple economies, a good passes through many stages on its way to or from the border. In each of these stages, costs are added, which reduces the proportionate impacts felt by individuals relative to those on the border, and often substantially reduces the predicted effects of liberalisation. If the internal distribution sector is not competitive, the pass through of price changes may not be complete, perhaps even completely frustrating the liberalisation. The most obvious example is where monopolistic marketing boards fail to pass on price increases on export goods. But merely abolishing these boards is not sufficient; as we shall argue in Section 3, one needs to pay attention to what replaces them.

If a trade liberalisation itself - or, more likely, the changes in domestic marketing arrangements that accompany it - lead to the disappearance of market institutions, households can become completely isolated from the market and suffer substantial income losses. This is most obvious in the case of markets on which to sell cash crops, but can also afflict purchased inputs and credit. If official marketing boards provided credit for inputs and against future outputs, whereas post-liberalisation private agents do not, no increase in output prices will benefit farmers unless alternative borrowing arrangements can be made.

This discussion prompts three comments. First, and blindingly obvious, is that the effects of liberalisation depends on where you set off from. If a government purchasing monopoly subsidises remote farmers, the first round effects of liberalisation will be to hurt those groups. Second, liberalisation usually affects many goods at once. When some are inputs into the production of others, the net effect is quite complex and it is important to consider the balance of forces.

Third, we need to know how a household will accommodate price changes. For example, an adverse shock may entail large losses of utility if no alternative activities exist, or relatively small losses if they do. [Similarly positive shocks may deliver great benefits if farmers can switch their activities to take advantage of then.] Additionally,

[3] Elson (1991) provides a useful overview of these non-separabilities and their consequences.

accommodation will transmit the shock to other markets and set off a whole series of second-round effects. It is important to know how these ‘spill-over’ markets equilibrate themselves.

For example, the price of a good that is traded internationally will be almost entirely determined by the world price, whereas those of goods that are traded only locally will probably experience quite significant changes, albeit that only a few people will be affected.
The 'growth linkages' literature, e.g. Delgado et al (1998) and Mellor (1999) argues that agricultural liberalisation and productivity growth are so effective at poverty alleviation because their demand spill-overs are heavily concentrated on relatively localised activities in which the poor have a large stake - construction, personal service and simple manufactures.

Finally there are two sets of goods for which explicit prices are not observed: first, subsistence goods, which are likely to be particularly important in considering gender aspects of poverty, and goods that are just not available. The latter may represent an important source of benefit from liberalisation – see, for example, as Booth et al (1993) on Tanzania and Gisselquist and Pray (1998) on inputs to agriculture in Bangladesh.

## *2.3 Wages and employment*

An important mechanism by which foreign shocks are translated into poverty impacts is through the activities of enterprises, especially in terms of wages and employment. Indeed, the loss of a job is probably the most common reason for the precipitate declines into poverty that catch most public attention. A critical dimension here is how labour markets work.

Start with traditional trade theory, in which factor supplies are fixed and wages are flexible. The famous Stolper-Samuelson Theorem predicts that an increase in the price of the good that is labour-intensive in production will increase the real wage and decrease the real returns to capital. Unfortunately, however, while its basic insight seems likely to be robust, the Stolper-Samuelson Theorem is not sufficient to answer questions of trade and poverty in the real world. For example, even if increases in the prices of unskilled-labour-intensive goods raise unskilled wages, poverty will be alleviated only if poor households rely largely on unskilled wage earners.

In world terms developing countries are clearly labour-abundant, so that freer trade gravitates towards higher wages in general. However, within those countries it is not clear that the least-skilled workers, and thus the most likely to be poor, are the most intensively used factor in the production of tradable goods. Thus while, for example, the wages of workers with completed primary education may increase with trade liberalisation, those of illiterate workers may be left behind or even fall. One of the reasons that agriculture is such an important element in any forthcoming round of world trade talks is that for this sector we can be reasonably confident that very-low-skilled workers in rural areas will benefit through the production responses.

It is sometimes suggested - at least implicitly - that the factor intensity approach to the distributional effects of trade policy is refuted by the failure of Latin American liberalisation in the 1980s to alleviate poverty. Without denying the need for refinement in the argument, we would rather argue that the alleged surprise arose more from faulty premises than from theoretical failure. Thus, as Wood (1997) argues, by the 1980s Latin America was not obviously the unskilled-labour abundant region of the world economy: both China's 'arrival' in world markets and/or Latin America's abundant natural resources suggest otherwise. Similarly the growth of outsourcing, for which Northern firms do not find it most efficient to seek the lowest-grade labour, suggests that Mexican exports are intensive in labour that is relatively skilled by local standards - Feenstra and Hanson (1995). Also for Mexico, Hanson and Harrison argue that the initial structure of tariffs protected unskilled workers and thus that it is hardly surprising that liberalsiation reduced their wages. Finally, of course, it may take time for markets to clear. Thus Chile's liberalisations (trade and otherwise) were associated with worsening inequality over the 1980s, but inequality measures have now returned to pre-reform levels - and at vastly higher average income levels and lower poverty levels - World Bank (1997).

The alternative polar view of labour markets in developing countries is that labour is available in perfectly elastic supply. In this case the wage will be fixed exogenously by what labour can earn elsewhere and the adjustment will take place in terms of employment. Then the reason for the fixity of the wage matters. If it is fixed by the existence of a subsistence sector, moving workers into the formal sector will alleviate poverty only if the loss of labour in subsistence agriculture allows the workers remaining in that sector to increase their ‘wage’. This might happen either because the subsistence sector begins to run out of labour (the case of successful development) or because the workers had negative social product in that sector (e.g. overcrowding)

If, alternatively, the formal sector faces an enforced minimum wage (above poverty levels), at which there is excess supply, poverty will be affected by a trade shock. If it raises the value of the marginal product of labour in the formal sector, trade liberalisation reduces the cost of the minimum wage enforcement and alleviates poverty. If, on the other hand, it reduces the value of the marginal product and thus reduces employment, it has adverse consequences.

Capital might also be available in infinite supply – e.g. from multinationals at the world rate of return. In this case the inflow of capital into the liberalised sector is likely to boost wages and/or employment, which will increase the welfare benefits and, if they exist, the poverty alleviation benefits, of a trade liberalisation. It is important to remember, however, that not all capital inflows are desirable; if they occur in response to market distortions they may subtract value from the economy rather than add it - so-called immiserising growth, see Winters (1991).

In assessing the strength of these firm and factor market processes it is important to know how far the initial price shock will be disseminated across the economy. One important determinant of this is the degree of substitutability between imports and exports on the one hand and domestic varieties on the other. If substitutability is weak, the transmission of trade shocks into domestic price changes are correspondingly attenuated. It is also important to realise that in addition to factor prices, factor demands will depend on the prices of other inputs, taxes and other constraints on output (e.g. regulations). Partial equilibrium analysis of firm responses to liberalisation - e.g. Tybout (1997) and Bigsten et al (1998) on Africa and Roberts and Tybout (1996) more generally - suggest that these factors can be very important dampeners on the general equilibrium effects discussed in this sub-section.

## *2.4 Taxes and Spending*

A major fear, although not universally justified by any means, is that trade liberalisation reduces government revenue. If the compensatory increases in other taxes or decreases in expenditure impinged heavily on the poor, poverty could be exacerbated. Given the association between stabilisation and liberalisation over the 1980s, these worries have some historical basis, but it would be mistaken to assume that the association is immutable. What is clear, however, is that care and political focus are required to ensure that this indirect route does not lead to adverse effects on poverty.

The effects of trade shocks on revenue extends beyond the simple analysis of tax rates. Adjustment to new prices affects the quantities of other goods purchased and if these pay taxes or receive subsidies, net revenue is affected. These effects can off-set effects on households so that the effects of a shock on national welfare have a different sign from the household effects. Suppose, for example, that because of taxes on local agriculture, a country imports food. Rising world food prices, that were passed through to farm households, would harm them as consumers, but if they simultaneously produced more food and paid more taxes, the net welfare result would be positive.[4]

A more interesting question is whether trade liberalisation restricts a government's ability to manage spending and taxation in a way that impacts poverty. Binding a liberalisation at the WTO makes the price-reducing effects of tariff cuts less reversible and constrains a government's ability to manipulate policy in other arbitrary ways. Given that such manipulation very often redistributes real income from the poor to the rich, and that uncertainty reduces the incentives to invest, the constraints are likely to be beneficial. That is, tying one's own - and one's successor's - hands can be constructive politics.

Much more common is the fear that bindings and / or commitments at the WTO prevent governments from pursuing pro-poor interventions through, for example, production subsidies or border stabilisation policies. These arguments are essentially specific examples of the analysis above: they are trade interventions whose direct effects can be traced via the distribution and enterprise sectors. In addition, however, they have systemic effects because they affect whole classes of policies. For example, even if some subsidies would be advantageous, given the difficulty of identifying these cases and preventing their capture by interest groups, a blanket ban may, on balance, be advantageous.

Finally, some have argued - e.g. Rodrik (1997) - that increased openness reduces governments' abilities to raise revenue because mobile factors can no longer be taxed.

[4] The reversal result depends on taxes being the cause of the country being a net importer rather than a net exporter, but the general idea of off-setting revenue effects is much broader. Similarly it is perfectly possible to record net national economic benefits while households suffer if shocks stimulate returns to firms / capital.

If so, social and redistributive expenditure could be under threat. In its direct form this argument applies only to factors that can change locations in response to taxation (or other) incentives, so international trade policy is only indirectly relevant. On the trade side, increasing world competition makes it more costly for an individual country to tax exports in terms of both eroding the tax base and distorting production patterns. However, it is not clear that individual countries have ever had much scope for such taxes in manufactures, which is where trade barriers have come down most strongly in recent decades.

While the reduced ability to tax capital is clearly a problem for governments intent on redistributive policies, it does not preclude all possibilities. First, most countries collected only a small proportion of their revenues from capital taxation even when economies were very closed. Second, in fact, many governments subsidise inward investment rather than fret about not being able to tax it. Third, there are other redistributive policies which are not vulnerable to this difficulty. For example, for tackling poverty, Bowles (1999) lists land reform, re-assigning property rights implicit in use of the commons, public-brokered risk sharing, greater accountability in the provision of public services, and removing or reducing discrimination. None of these is easy, but they certainly remind us that taxing capital is not the only route to helping the poor.

## *2.5 Shocks, Risks and Vulnerability*

The static analysis so far compares two perfectly stable scenarios, but, in reality, the real world is full of shocks. Thus we need to think about how trade liberalisation affects the <u>chances</u> of falling into poverty (or of emerging from it) in an uncertain world.

If foreign and domestic economies are subject to independent random shocks, simple risk spreading suggests that, at most countries' initially low levels of trade, more trade would reduce risk exposure.[5] Most obviously, if farmers produce a crop which is transformed from non-tradable to tradable status, this is likely to reduce variability since for most goods world markets are more stable than local ones.

Another possibility, however, is that liberalisation leads farmers to switch from crop x (subsistence food, say) to crop y (cash crop). Their risk then switches from var (x) to var (y), and thus could obviously increase. However, only if this switch is not made willingly and knowingly or if there are external effects, can we assume that it is welfare worsening, even if the variance of prices or incomes increases. For example, if adult males receive the returns from cash crops but females and children bear the risks of failure in terms of nutrition or schooling, the decision to switch may not be welfare enhancing for the household overall. The important point analytically is that not every *ex post* descent into poverty is the result of an *ex ante* flawed response to trade liberalisation.

[5] The relative sizes of and correlation between the two sets of shocks could reverse this conclusion, but are not likely to.

One fear is that, because trade liberalisation in the context of a GATT Round alters the set of feasible policies, it affects the ability of governments to operate stabilisation policies. Thus, for example, if prior to liberalisation domestic food prices were stabilised by varying the restrictiveness of trade policy (e.g. variable levies, allowing imports only in periods of shortage), moving to a fixed tariff could increase instability. Thus the Uruguay Round constraints on variable levies or on export subsidies, for example, could increase instability in certain economies even if they raise average incomes. If economies are inherently inflexible, increasing instability could increase the incidence of poverty. However, one would need to know that policy was actually being used effectively before the change to judge this a loss.

## *2.6 Economic Growth and Technology*

Economic growth is the key to permanent poverty alleviation. It is also strongly related to contemporaneous reductions in poverty – see, for example, Bruno, Ravallion and Squire (1996) or Roemer and Gugerty (1997). Unless growth seriously worsens income distribution the numbers in poverty measured in any absolute way will fall as average incomes increase. The balance of the evidence seems to be that although growth is often associated with growing inequality (or economic decline with narrowing inequality), the effects on poverty tend to be dominated by the advantageous direct effects. An example is Chile - Fierrera and Litchfield (1999) - where growth reduced head-count poverty while still allowing the very rich to increase their share of national income. Thus, if there is any truth in the claims that openness enhances growth, we might reasonably expect it to have beneficial effects on poverty through that route alone. Certainly we would need strong case-specific information that a particular trade liberalisation seriously worsened income distribution before adopting the contrary view.

Controversy rages about the link between trade liberalisation and growth. There is a widespread belief that openness, fairly broadly defined, stimulates growth, although the most commonly cited studies - e.g. Dollar (1992), Sachs and Warner (1995), Edwards (1998) - have received pretty rough treatment recently from Rodriguez and Rodrik (1999). Moreover, these studies include open trade (the *result* of trade liberalisation) as only one of several indicators of openness and one which generally seems to weigh rather lightly in the overall result - e.g. Harrison (1996). In part, one suspects, this is because of the extreme difficulties of measuring trade stances once one comes inside the boundary of near autarchy. Overall, the fairest assessment of the evidence is that trade liberalisation alone has not been shown unambiguously to foster growth, but that it has certainly not been identified as a hindrance. Trade liberalisation does have a positive role, however, as part of a package of measures promoting greater use of the market, more stable and less arbitrary policy intervention, stronger competition and macro economic stability. With the exception of the last, an open trade regime is probably essential to the long-run achievement of these stances, and thus should be seen as a major contributory factor in economic development.

Any link from openness to growth probably operates at least partly by enhancing technical progress. The evidence that access to imports enhances performance is quite strong Esfahani (1991), Feenstra et al (1997), and Gisselquist and Pray (1998) while that which postulates a link from exporting to technology is, perhaps surprisingly, weaker. Similarly it is quite difficult to prove that FDI boosts efficiency e.g. Haddad and Harrison (1993).

Of course technological flows need not depend just on trade or technology policies in a WTO-sense; they may arise autonomously or through direct interventions in research and development in favour of developing countries. An example of the latter might be the green revolution, which most commentators hold to have been a significant step forward in poverty alleviation. The increasingly private nature of technology (through aggressive IPR regimes) is a current concern in this area. The poor’s lack of resources may preclude them from acquiring new advances and discourage scientists from addressing the problems of most significance to them. The critical examples of this are, perhaps, South Africa's difficulties in acquiring anti-AIDS cocktails at reasonable cost and the failure of pharmaceutical companies to work seriously on malaria.

## *2.7 Short-term Adjustment*

Reaping the benefits of trade liberalisation more or less requires adjustment in a country's output bundle. If adjustment is costly, it could lead to periods of decline and / or poverty before things get better. Even if the social costs of adjustment are low and outweighed by the benefits, private costs could be significant. The most significant adjustment problem lies in factor markets, especially employment; the two critical questions are: how long are spells of unemployment / underemployment, and who suffers them.[6]

The key to ‘how long’ lies in the flexibility of the labour market. Unfortunately, there is apparently very little research directly on labour turnover in developing countries - Matusz and Tarr (1998). However, it suggests that problems are far from inevitable, especially in cases where workers have been very poorly paid prior to liberalisation. For example, Harrison and Revenga (1998) find manufacturing employment increasing almost immediately after half the liberalisations they study. The less rosy scenarios appear to have one of two characteristics. First, they refer to cases where truly huge shocks have occurred on a far wider scale than just trade liberalisation - the other half of Harrison and Revenga’s sample are mostly transitional economies – or where, say, a town’s only plant is shut. Second, workers may suffer long-lived and deep losses of income if they have previously enjoyed very high levels of protection or if they had built up strong firm-specific human capital.

‘Who suffers?’ Transitional unemployment (or declining rewards for skills) is unfortunate for anyone who suffers it, but it does not necessarily lead to poverty. Individuals who have lived beyond the reach of poverty for some time will generally have assets, or access to credit, with which to smooth consumption. The initially poor, on the other hand, will have very few assets, and so will be unable to smooth over even short spells of unemployment. Hence, even switching from one unskilled informal sector job to another could cause severe hardship, especially if temporary

[6] It is the nature of adjustment or transition costs that they are temporary. Permanent losses are strictly the business of previous sections, although, of course, in practice it requires great confidence in one's analytical and empirical tools to claim to be able to separate permanent from temporary job loss *ex ante*.

stress led to permanent or semi-permanent consequences, such as losing one's place in the queue for rented housing or education services. This suggests that attention to transitional unemployment should mainly be focussed on those who were poor or near-poor initially. This is not always the case in practice, for typically the middle class will be more articulate and more influential politically than the poor.

## 3. On the Ground in Africa

This section draws on research undertaken jointly by IDS and Oxfam in mid-1999 in Zambia and Zimbabwe – Oxfam-IDS (1999). Based on field interviews plus validation from secondary sources, they aimed to identify the different ways in which poor people have been affected in Zimbabwe and Zambia over the past decade and, wherever possible, to understand how these changes came about using poor people's own perceptions of changes in their environment. Specifically they focussed on comparing *a priori* expectations and actual outcomes of liberalisation, and identifying the groups most likely to be subject to short-term negative effects. The contrast between the two economies provides a powerful tool for elucidating some of these issues. IDS/Oxfam also draw policy conclusions about implementing liberalisation in a poverty-friendly way, which we report in section 6. below.

The work described in this section concentrates mainly on the effects of commodity price changes, but we do not assert that none were felt via the other routes outlined above. However, we do believe that in poor agrarian economies the price effects are probably the main ones and, that our method here, participatory research, is better suited to identifying direct price effects than the macroeconomic consequences felt via other routes.

### *3.1 Defining Liberalisation*

Empirical work on trade liberalisation is bedevilled by the difficulties of identifying the phenomenon itself. In theory it is the reduction of the official barriers to trade which distort the relative prices of tradable and non-tradable goods and those between different tradables. In practice, even if all the distortionary policies are identifiable, which is rarely the case, it is difficult to gauge the overall degree of liberalisation because one does not know how effectively the promised policy changes have been implemented nor how the various changes interact at a detailed level.

The way round this problem in the African study is to define liberalisation implicitly as a practical outcome rather than a set of policy inputs. Policy changes such as the creation of uniform tariff regimes or the removal of subsidies are not ends in themselves, but steps towards a goal. We aim to identify whether the goal was achieved. If it was, then the consequences of the liberal goal can be identified and appropriate lessons drawn. If it was not, then there may be lessons for future implementation such as in policy design or complementary measures to neutralise the negative consequences of implementation. Once identified, these lessons may then be applied to future unilateral or multilateral liberalisations.

For the purposes of analysing its effects, we have tried to observe liberalisation as a process which:

- provides more uniformity of policy treatment between different economic activities; and
- encourages competition in markets.

Focus on specific policy measures is explicitly avoided in defining liberalisation, although not, of course, in explaining history: the discrepancy between precept and practice may be an explanation for differences between *ex ante* expectations and *ex post* perceptions.

It is worth noting that recent multilateral accords on liberalisation have had very little practical effect so far on either Zambia or Zimbabwe. Both countries have gone further as a result of unilateral decisions than they have been required to do by multilateral ones. The unilateral decisions were taken at a similar time to those relating to other aspects of the structural adjustment agenda and owed almost nothing to the WTO or other plurilateral trade agreements, such as the Lomé Convention or the SADC Trade Protocol. It is not possible to disaggregate the effects of trade liberalisation from those of the structural adjustment perfectly, but the theoretical discussion above does offer some guidance about what may reasonably be attributed to the former. In the case of Zambia we also need to separate out the effects of rapidly declining minerals revenues.

After years of fierce import substitution, both Zambia and Zimbabwe initiated trade reform in 1991, but where the Zambians have been bold, orthodox and unidirectional, the Zimbabweans have been hesitant and rather opaque. Indeed, the latter never fully reformed their tariffs and, following the 1997 macroeconomic crisis, actually started to backtrack. In terms of the outcomes noted above, however, it appears that the Zimbabweans have achieved greater liberalisation.

### *3.2 Perceptions vs. data*

Since 1991, Zambia has had three household surveys of around 10,000 households each (1991, 1993 and 1996). These suggest that, despite a marked worsening in average incomes as copper prices fell and stabilisation was pursued, and an increase in the proportion of the population in poverty, the depth or severity of poverty declined significantly over 1991-96 – McCulloch and Baulch (1999). In particular, this appeared to be due to improved conditions in rural areas. These results are at variance with the results of the IDS-Oxfam fieldwork, where considerable hardship and criticism of the reform process was reported.

We can not resolve the discrepancy between data-sources at this distance, but note that it calls for caution in any attempt to draw conclusions from either source of data on its own. It also, perhaps, suggests a role for better public information exchange: collecting better data and informing the public better about what to expect from policy reform.

### *3.3 Markets – Better, Worse and Missing*

The over-riding conclusion of the field research is the critical role of markets in determining the poverty impacts of trade and other liberalisations. Where conditions for the poor have improved this has usually been associated with the better performance of and access to markets. Where they have worsened, faulty markets are generally to blame and in the extreme cases, the problem is often missing markets. We illustrate this with three cases – one success, one failure and one warning.

### Cotton in Zimbabwe:

Despite the hesitant and partial nature of liberalisation *policies* in Zimbabwe, there appears to have been a substantial improvement in *outcomes*, including an increase in competition in the cotton market (Table 3.1). Before the reforms, the Cotton Marketing Board used its monopsony to impose low producer prices on farmers in order *inter alia* to subsidise 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.

Following deregulation and privatisation, 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.

**Table 3.1: Changes to markets: cotton in Zimbabwe**

**Before:**

- monopsony buyer (CMB) used low producer prices to subsidise inputs into textile industry;

⇩

- commercial farmers diversified into unregulated crops such as horticulture and tobacco; small farmers suffered;

**Now:**

- deregulation and privatisation;

⇩

- competition between three buyers;
- some buyers offering input supply;
- prices have risen (in current terms).

## Maize in Zambia:

Such changes are precisely what the reforms in Zambia were intended to achieve. But here the result has been very different. In the case of maize (Table 3.2), the better-favoured areas have seen no effective change in market conditions, while the less-favoured regions have witnessed a deterioration. Given that the *status quo ante* was relatively favourable for smallholders, especially in remote areas, it is easy to see why these changes have failed to promote a substantial increase in maize production or an improvement in the conditions of poor maize farmers.

**Table 3.2: Changes to markets: maize in Zambia**

**Before:**

- government subsidised inputs;
- government/co-operative crop purchasing;
- pan-territorial, pan-seasonal pricing;

- growth of (imported) input-dependent production across the country.

**Now:**

- input prices have risen;
- markets for crops have shrunk (especially away from line of rail and major roads);
- limited availability of sustainable seeds;

- fall in area planted to maize and production;
- only partly offset by growth in more sustainable coarse grains because of consumer preference for maize;

- shift to cotton which is less profitable, but in which 'better' markets exist.

Under the old regime, remote farmers were subsidised by those close to the line of rail (through pan-territorial pricing) and small farmers by larger ones with storage facilities (through pan-seasonal pricing). In addition, the agricultural sector as a whole was subsidised by mining. All of these subsidies have now been removed. Remote farmers are unambiguously worse off, whilst larger ones and those close to the line of rail are probably also less well off, since the subsidies from mining probably exceeded the tax in favour of remote areas.

But the deterioration in the situation of remote farmers is substantially worse than would have arisen solely from the removal of pan-territorial pricing. For them, functioning markets have largely disappeared. The *status quo ante* was one of a monopsony parastatal buyer; the *status quo* is that often there is no buyer at all or, if there is, the terms of trade are so poor that transactions occur on a barter basis.

It is difficult to disentangle the relative importance of institutional and infrastructural factors in this market failure. There has been such a sharp deterioration in transport infrastructure that it is difficult for traders to reach areas that are more than a relatively short distance from a major route. It is an open question whether trading would be more active if infrastructure were better, or whether there are also institutional impediments. But in other areas, there are clear institutional constraints on top of the logistical ones.

It might reasonably have been supposed that farmers would react to the change in relative prices of maize inputs and outputs to shift production into crops that are less dependent on imports. This has happened, but only to a limited degree. In some cases farmers say they have lost either the knowledge or the physical inputs required to shift production back to subsistence varieties and crops.

The Zambian case also reveals the marked reluctance of small farmers to take on market risk. The period of subsidised, pan-territorial and pan-seasonal pricing in Zambia will have coloured farmers' views of the desirability of stability over volatility, but it is clear that for one reason or another they fear risk. The lack of price guarantees for output and the need to rely on unregulated markets for inputs in the maize sector has contributed to a shift into the production of cotton where a private monopoly offers the *apparent* stability formerly provided by the state. In practice, farmers do bear exchange rate risks, but the private company is performing an extension and marketing role that is not available from other sources and which, evidently, the farmers appreciate. The willingness of traders to supply inputs and to provide credit can become a major determinant of crop choice in these circumstances.

**Maize in Zimbabwe:**

Zimbabwe was more successful in liberalising maize than was Zambia and it seems clear that small and poor farmers benefited in this sector also. In 1998, however, in response to food riots, the government stepped back into the market to control maize and maize meal prices. The results have been falling commercial output and static or falling small-scale/communal output. By squeezing the margin between maize meal and its input, maize, the government is in danger of suppressing the market, at considerable cost to the poor consumers of maize meal. In addition, the poor state of rural roads is causing private firms to reconsider the economics of buying from remote farms. See Box 3.1.

## *3.4 Transmitting price signals*

The supply response to a liberalisation depends on how much of it finds its way through to farmers. As we noted above, even if there are no market failures, the mere fact that there are transactions costs attenuates the proportionate price changes that get through to farmers. Box 3.2 shows just how large these can be.

## *3.5 Re-allocating Resources*

The reforms in Zambia and Zimbabwe not only affected poor farmers' choice of crops. Other re-allocations occurred too. The most emotive was the decline in manufacturing as the protection it had previously received was unwound. In Zambia formal employment has declined by 15% since 1991. The informal sector does not generate much income, so it may be presumed that at least some of the people affected have descended into poverty. The direct effect of the decline in employment is not particularly large, since perhaps only 13% of the workforce is in the formal sector. However, since the evidence suggests that remittances comprise around 30% of rural poor families' incomes (World Bank, 1996), the indirect effects could well be more significant. The liberalisation led to declines in output in all sectors of manufacturing except for food, beverages and tobacco, although textiles and clothing is now showing signs of recovery.

In Zimbabwe, public sector retrenchment has also been important, leading to poverty among those not innovative or skilled enough to succeed in small-scale businesses funded out of redundancy monies. These people, who illustrate the private costs of losing highly preferred positions, are officially referred to as the 'new poor'.

The general decline in incomes and formal-sector opportunities has led increasing numbers of people to set up in the informal sector, including many women. They report having to work harder than previously, but some appreciate the increasing independence that their incomes give them. Most informal businesses are in the trade and service sectors rather than manufacturing, and our survey uncovered substantial increases in trading activity. This typically did not generate high returns, but it was a vital component of household income – see  Box 3.3. There is, however, evidence that the very poor are not able to start even these low-level informal activities because they do not have the capital. Thus trading is better seen as a coping mechanism to help the slightly better off avoid falling into extreme poverty than as a solution to the plight of the poor *per se.*

## Box 3.1  A crisis in Zimbabwe's maize marketing system

Ephraim Nyakajuara grows maize in the Headlands Resettlement Area, near Rusape in Manicaland Province.   Until recently, he and his fellow farmers were selling their maize crop through private traders, Viema Africa Pvt Ltd, to National Foods Ltd.   National Foods has decentralised the buying of maize to its depots, which are spread all over the country.   This was benefiting farmers and private traders alike partly because of the company's policy of prompt payment.   Mr Nyakajuara has vowed not to go back to selling his maize to the parastatal, the Grain Marketing Board, because it can take up to six weeks to get payment.  But he may have little choice.

National Foods has decided that it will not continue to provide free transport for private traders, like the Viema Africa because they were only just managing to buy the minimum amount of seven tonnes from the resettlement and communal areas around Rusape.  The poor state of the roads connecting Headlands to Rusape was a major factor in National Food's decision.   But there is also a mounting crisis in Zimbabwe's maize marketing system stemming from the government's decision to increase the price of maize through the GMB while controlling the price of maize meal.   Millers claim they cannot afford to buy maize without increasing substantially the price of maize meal.

Given the current impasse between the state and millers and the uncertainty of the industry, National Foods has issued a directive to all their depot managers instructing them to stop buying maize from private traders or farmers.   In early June 1999 Zimbabwe was facing a shortage of maize meal, which is effecting 20,000 jobs in the industry.  During our study there was evidence of shortages of maize meal in most shops.   Millions of Zimbabweans depend on commercially produced maize meal as a staple food.   The unfair pricing regime is a threat to poor producers and is likely to exacerbate urban poverty.

## Box 3.2 A private trader's perspective

The cost of delivering produce from Zambia's Northern Province to the main regional and domestic markets is very high.(Keyser 1999).

Most trade in Northern Province is through small independent operators, like Mr Kazilimani, who lives in Kasama, the provincial capital of Northern Province. He explained that generally he travels in a team of three or four buyers to a village area using public transport over a secondary dirt road. His fellow buyers may come from Lusaka, the Copperbelt or a town in Northern Province itself. The buyers carry with them the cash they plan to spend or bring a set of goods including used clothing, soap, salt, blankets and other items for barter. Over the next 2–3 weeks, the traders will camp in the rural area and seek to buy as much agricultural produce as possible with the funds and good they have bought. This often involves travelling by foot to isolated villages and paying local labour to transport the produce back to the roadside by whatever means possible.

After reaching Kasama or some other district town in Northern Province, the traders then either sell their commodities locally or look for further transport to the Copperbelt where agricultural prices are often more attractive. Mr Kazilimani estimates that he collects and sells about 2 to 5 mt over roughly one month. Reasons for this low volume include problems of finding sufficient quantities for sale and a lack of operating capital. Many farmers only sell about one or two 20 litre tins of beans or groundnuts for cash each year (about 15–30 kg) so the time that it takes to amass a reasonable volume for trade can be substantial. According to Mr Kazilimani the cost of delivering a single 90 kg bag to the Copperbelt works out at ZK 19,682 and ZK 21,742 (£5.17–£5. 72) for purchases from villages located 50 km and 100 kms respectively from Kasama. The cost of hiring a truck to move the crops from the roadside into town is a substantial component of his transaction costs.

One important outlet for marketed maize in Northern Province is GBM Milling based in Kasama. Even though in early 1999 the mill was operating at less than 40% capacity, Mr Kazilimani explained that GBM still preferred to buy maize directly from commercial farmers located as far away as Central Province rather than from traders like him. Once the costs of trading at the village are taken into account, according to GBM, it is actually more expensive to buy from local farmers than far away commercial growers.

There is a tendency to see trading and service as not being 'real' jobs – even in the USA (worried about becoming a nation of hamburger-flippers) – but one should not underestimate their contribution to the economy. Trading activities in second-hand clothes quite clearly contributed to keeping prices down in both Zambia and Zimbabwe, boosting real incomes among consumers but placing pressure on producers. Trading artefacts across borders has become an important source of income for some women – via both exports to OECD countries and local trade with Botswana and other neighbours.

**Box 3.3 Supplementing rural incomes**

Jetina Muwira lives with her family in a communal area, Chisarasara in Masvingo Province.

"The main problem that I see is malnutrition. This is because of the drought that has been with us for so many years. Since 1980 the rains have been bad, and each year it gets worse. The fields grow dust and stones. Collecting water for drinking and cooking is very hard work."

Mrs Mugwira combines subsistence agriculture with trading in handicrafts, selling the pots she makes to the tourists travelling between Harare and Bulawayo. She works with 70 other women and their work is very labour intensive. There is no electricity and so they fire the pots in the traditional way, collecting firewood, which is becoming scarce. The disadvantage of this method is that its limits their output to 10–30 pots a session. "We have many problems, but right now our biggest worry is the shortage of fuel." She estimates that over the past couple of years she has earned ZW$ 1,409.15 — low even by subsistence standards.

"I have hopes for the future. For my family, I hope that the rest of my children can finish schooling. I want them to have proper education, so that they will be happy with good jobs and a good life. But I see problems. The cost of everything goes up – school fees too, and we don't earn enough to save much money – apart from the pottery, there is soap making, sewing school uniforms and crocheting, cattle fattening and gardening. If we can keep these ventures going and make them stronger maybe they will help to solve some problems. People are working hard and trying hard – but really, in this drought without water, moving forward is very difficult."

The agricultural reforms have clearly stimulated commercial farming, in both traditional and non-traditional (horticulture) sectors. This has beneficial implications in terms of spillovers to local markets and in terms of the tax base if governments can exploit it. It has also led to increasing numbers of jobs for farm workers – 40% increase 1988-97 in Zimbabwe. These jobs probably contribute to alleviating rural poverty, but there are concerns that, at least among middle- and small-sized employers, conditions are so bad that the net gain in worker welfare is negligible.

Urban and peri-urban consumers have benefited from the growth of more modern retail outlets in Zimbabwe. Competition between them has kept prices down, as has the emergence of wholesaler-chains willing to deal with the public. These retailers have emerged as transportation services have improved following the relaxation of foreign exchange controls and spare part policies, and supplemented by the growth in the pool of labour willing to provide service.

# 4. Labour Markets in South Asia

The second series of empirical studies in the DfID project on 'Trade and Poverty' was in India, along with background work on South Asia more generally – CUTS (1999). This focussed on the labour market and comprised some sectoral analysis, an econometric study of poverty at the state level, small surveys of employers and workers in selected sectors, interviews with players in the social sector plus input from a high-level focus group. Here our focus is on our 'enterprise' sector links, via wages. There are likely also to have been price effects, although the weak liberalisation in agriculture means that the main commodity prices relevant to the poor were not shocked very much.

The interviews from the social sector (trade unions and NGOs) uncovered a deep suspicion of trade liberalisation and globalisation, especially in its effects on labour. Respondents argued that labour had suffered from past liberalisation and that any future benefits would, if they existed at all, accrue to only a few relatively well-off individuals. If nothing else, these results suggest the need for detailed work on the issue, because the initial statistical evidence is far from being so universally damning, - see below.

## *4.1 Defining Liberalisation*

Contrary to the African approach, in India we defined liberalisation explicitly. Since 1991 a series of reforms of both border measures and internal regulations has occurred, freeing up many aspects of industrial trade and production. Implementation has been patchy and the reforms have been less bold for consumer goods and agriculture. Despite these holes, however, we have taken the period since 1991 as a *prima facie* industrial liberalisation and have sought to identify its effects by looking at changes in industrial wages since it began. Translating changes in wages into changes in poverty has not been possible formally because we do not know how wage earners map into households, but some conclusions have been possible.

## *4.2 Wages and Employment*

If we can take India as a labour abundant country - which seems reasonable - we would expect trade liberalisation to increase the demand for labour, especially in the formal sector. As section 2.3 and box 4.1 point out, how this affects poverty depends heavily on how the labour market functions - specifically on the elasticity of supply of labour. If the elasticity is zero, wages will increase but not employment, whereas if it is infinite, employment increases but not wages. In fact, the truth almost certainly lies in between.

**Box 4.1 Trade, Poverty and the Labour Market**

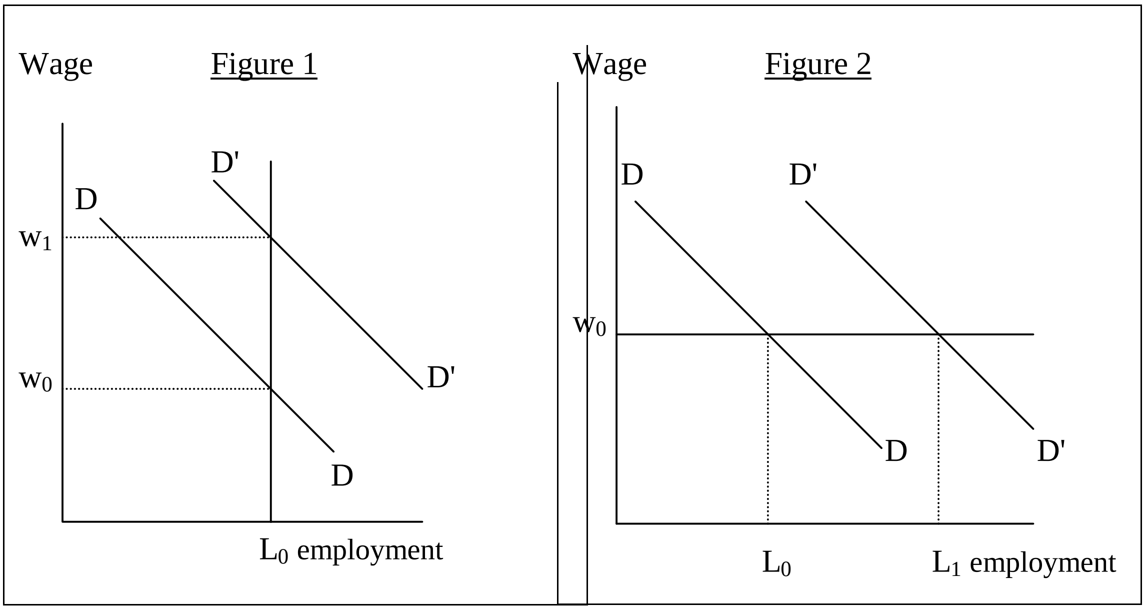
The classic link between international trade and poverty in developing countries is via the labour market. If opening up to international trade allows a country to export more labour-intensive goods and replace local production of capital and skill-intensive goods by imports, it increases the demand for labour - typically in the formal sector.[7] If poverty is concentrated among people who are actually or potentially part of the labour market, increasing demand will help to alleviate poverty. But how, and whether, it does so depends significantly on how the labour market operates.

Consider two extreme assumptions. In figure 1 we assume that the supply of labour to the formal sector is completely fixed. When the demand for labour shifts out from DD to D'D', employment can not increase and the market must be brought back to equilibrium by an increase in wages from $w_0$ to $w_1$. If some of the workers in this market were poor - or were part of poor families - the increase in wages has a direct and beneficial impact on poverty. This is the classic "Stolper-Samuelson" result that appeared to work so strongly in East Asia over the 1970s and 80s.

The second extreme is illustrated in figure 2, where the supply of labour is perfectly elastic at the prevailing wage. Now an increase in labour demand is accommodated by increasing employment to $L_1$, with no change in wages. The effect on poverty depends heavily on what the additional workers were doing before accepting these new jobs. If they were engaged in subsistence activities - agriculture, scavenging - and earning the equivalent of $w_0$ initially, there is no change in their situation. Only if the switch into this labour market were so great as to significantly reduce labour supply to the subsistence sector and hence raise its "wage" there would be a poverty impact. In this case, the increase would apply to all workers in formal and subsistence sectors and so potentially would have very widespread benefits. However, the increase in labour demand would have to be huge to have a material effect on the wage. This case is really no less than the case of successful development, through which whole economies are transformed over a period of decades. Trade liberalisation is probably an important part of the process, but it is not the only one.

The alternative - and more common - case is that the wage in the formal sector exceeds the subsistence wage - possibly because it grants access to social services. In this case the workers who transfer to that sector experience a direct wage increase which almost certainly alleviates poverty. This is the situation in the Zambian Copperbelt where each mining job allegedly supports 14 dependants (Oxfam-IDS, 1999, p.30) and in India, where the formal sector manufacturing wage is substantially above the poverty line.

[7] Of course, if the country is not a labour-abundant one, or trade policy previously favoured labour very strongly, liberalisation may not boost labour demand.




Assuming that technology and other factors impose fairly constant rates of change on employment and wages through time, and that the process of trade liberalisation was added on top of these, we can infer the effects of the latter by examining the changes in the trends before and after liberalisation.[8] The simple theories of wages treat the national labour market as a unified whole and thus permit / require only one observation of wages and employment per period. Taking 1991 as the divide and allowing for the fact that liberalisation continued through the period after that, table 4.1 might suggest the effects of liberalisation on formal (or 'organised') sector employment in manufacturing:

**Table 4.1 Growth in the Organised Manufacturing Sector**

| | Before liberalisation 1987/8 – 90/1 | After liberalisation 1991/2 – 94/5 |
|---|---|---|
| Growth in employment (%) | 3.8 | 9.4 |
| Growth in earnings at constant prices (%) | 8.1 | 7.0 |

Source: CUTS(1999).

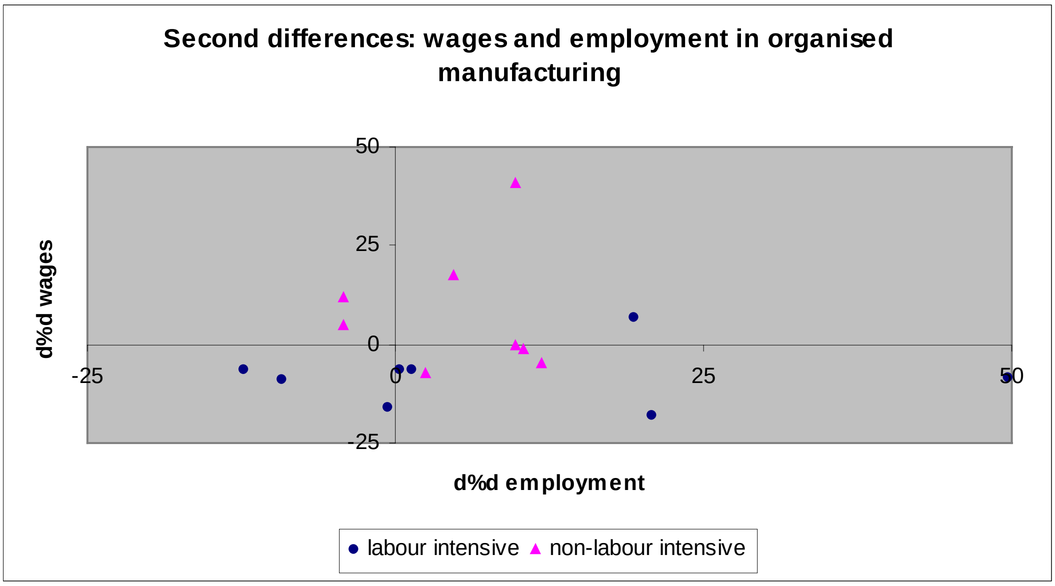
Table 4.1 shows that trade liberalisation was associated with a marked acceleration in formal employment creation, from 3.8% over three years to 9.4% over three years, but a slight deceleration in wages. This certainly suggests a "reserve army" (infinite elasticity of supply) view of the formal labour market, whereby workers are pulled into the sector but wages are not much affected. This view was also implicit in some of the replies in the surveys of workers. Those in sectors expected to gain from the

[8] This approach basically assumes that trade liberalisation affects the *levels* of employment and wages. Thus to observe changes in trend after 1991 rather than step changes, we need (a) time lags in the effects of liberalisation and (b) the increments to liberalisation over the post-1991 period. Eventually, as the process of liberalisation ceases, we assume that the growth rates of employment and wages will revert to their underlying levels.

liberalisation reported quite strong increases in employment following liberalisation but weak increases in wage levels for unskilled workers.[9]

The reserve army view also receives some corroboration from the disaggregated wage and employment data. We have data on 17 National Industrial Classification sectors. Splitting these into two roughly equal sized samples of labour-intensive and non-labour intensive technologies (labour intensive industries required in excess of 900 Mandays per Rs Lakh of value added in 1987/8), and plotting the changes in the percentage growth of employment and wages (denoted d%d) generates figure 4.1.

**Figure 4.1**




There is no discernible relationship between the second differences of wages and employment in labour intensive sectors, but in the crude data the relationship is mildly positive for non-labour intensive sectors (with a significant slope co-efficient of 0.21). However, the latter is due to two extreme observations - basic chemicals (employment acceleration of -113%) and rubber, plastic, coal and petroleum products (employment acceleration of 46%). These observations almost certainly reflect the statistical re-allocation of labour following vertical integration in petrochemicals, and if we combine them into a single observation (with employment acceleration of 10 and wage acceleration of –1) there is no significant relationship for non-labour intensive sectors as well. Figure 4.1 plots these adjusted data.

These results suggest that the reserve army model is a fairly satisfactory representation of the Indian formal manufacturing sector. Considering, however, that this is only a small and favoured part of a small sector perhaps this is not very surprising. The Indian work-force is probably between about 500 and 600 million. Manufacturing employment was estimated by the Hussain Committee at 40 million in 1990 (Hussain 1997) and is put at around 33 million by CUTS' (1999) data. Formal (or organised) sector manufacturing accounts for only approaching 7 million workers in 1994/5 in CUTS (1999).

[9] Note that table 4.1 refers to total formal employment and labour earnings, and thus extends well beyond the unskilled.

We do not have data on the evolution of wages in the informal (unorganised) manufacturing sector, but we can examine changes in employment between 1988/9 and 1994/5. It shrinks significantly from about 26.6 to 24.1 million. Within this total, rural unorganised sector employment falls by approximately 2.2 million (11% of the 1988/9 total) and urban by 300 thousand (5%). Interestingly the declines are concentrated in the labour-intensive sectors, in which formal sector employment increased more strongly.

With increases in formal employment and decreases in informal sector employment, it is tempting to conclude that trade liberalisation has been associated with a formalisation of jobs in labour intensive manufacturing. This not only seems as if it were a plus for poverty alleviation, but it is also what one would expect if exports are disproportionately drawn from formal sector firms. Unfortunately, however, the absolute numbers do not really support this view, with total informal jobs declining by 2.5 million and formal jobs increasing by only about 900,000. Such an aggregate decline is quite difficult to reconcile with trade liberalisation. The most likely explanations - if, indeed, the data are to be believed - are either that we are observing an exogenous trend, or that the real depreciation that accompanied liberalisation switched output from non-tradables to tradables and that the former are disproportionate users of the informal sector.

From a poverty perspective, the important question is what happened to those who lost informal jobs. If they could move back into subsistence or other agriculture at approximately the same wage, not much happened to them in poverty terms, and the observed formalisation seems to offer a net gain. If, on the other hand, the loss of an informal job signals a descent (deeper) into poverty, the net effects of these changes is negative for poverty alleviation. Unfortunately, we just do not know.

We have also looked at the change (not acceleration) in formal manufacturing employment and wages between 1987/8 and 1994/5 by state. These show a rather weak *negative* correlation, which suggests that they are dominated by supply shifts. In the absence of information about different states' trade exposure it is not possible to relate this phenomenon to trade liberalisation. We can, however, correlate the changes in wages with those in head-count poverty. It turns out to be significantly positive - increasing earnings are associated with increasing poverty! Recall, of course, that this is formal sector earnings. It is possible that exogenous constraints on labour force growth or increasing minimum wage levels are simultaneously raising wages and, by reducing employment growth, consigning more people to informal / unemployed status.

## *4.3 Wages and Poverty*

The critical issue for poverty is how wages compare with the poverty line - see section 2.3 above. Based on CUTS' interpretation of Dubey and Gangopadhyay (1998) we report in table 4.2 state-level poverty lines (expenditure per household of five (urban) or six (rural)) and various wage levels. They are also graphed in figure 4.2 in which we show poverty lines and twice the poverty lines as horizontal lines and wages as bars.

**Table 4.2 Poverty Lines and Wage Rates by Indian States, 1994/5**

| | Urban | | | | Rural | |
|---|---|---|---|---|---|---|
| State | **Poverty Line*** Rs | **Wages as % of Pov. Line** **Average** Average formal manuf. | Lowest in textile sector | Informal | **Poverty Line*** Rs | **Wages as % of PL** Informal |
| Andhra Pradesh | 9160 | 118% | | 87% | 7775 | 58% |
| Bihar | 9512 | 278% | | 80% | 9863 | 34% |
| Gujarat | 10573 | 129% | 118% | 108% | 9542 | 105% |
| Harayana | 8770 | 188% | | 258% | 9518 | 169% |
| Karnataka | 9955 | 176% | 165% | 117% | 8353 | 33% |
| Kerala | 10715 | 110% | | 80% | 10989 | 48% |
| Madhya Pradesh | 10685 | 164% | 116% | 159% | 8532 | 36% |
| Maharashtra | 10751 | 236% | 111% | 159% | 9485 | 48% |
| Orissa | 10282 | 154% | | 63% | 9305 | 52% |
| Punjab | 8344 | 163% | | 168% | 9984 | 103% |
| Rajasthan | 10024 | 168% | | 115% | 9702 | 148% |
| Tamil Nadu | 10301 | 136% | 182% | 129% | 9356 | 76% |
| Uttar Pradesh | 9237 | 187% | 144% | 105% | 8831 | 81% |
| West Bengal | 8461 | 219% | 153% | 105% | 10233 | 53% |

* The urban and rural poverty lines refer to five and six person households respectively.

It is clear that

- average formal sector manufacturing wages exceed poverty levels in every state. Even the lowest recorded wages for textile workers do; and
- wages in the informal sector frequently do not exceed the poverty lines.

To summarise this brief account of the statistical analysis in CUTS (1999), we have fairly optimistic signals about formal manufacturing employment and wages in India over the period of liberalisation. The growth rate in the demand for formal employment increased over the period concerned. At an aggregate level, it seems to have been manifest more in an acceleration of job creation than in wages, although real wage growth of 7% over 1991/2 - 1994/5 is not negligible. In the informal manufacturing sector, however, we find employment falling quite significantly over the same period. It is not clear what this owes to trade reform, but it may arise from the associated real depreciation squeezing non-tradables outputs. If we can apply the state-level data on wages and poverty lines to the national / sectoral data, we can infer that, because formal wages appear to be well above poverty levels while informal ones do not, increasing formal employment is likely to have a greater effect on head-count poverty than are wage increases. Thus overall, to the extent that the trade liberalisation was the principal difference between the two periods, we have a fairly optimistic picture from the formal data. In the informal sector, the question is whether losing an informal job indicated a decline from very low wages to something even worse or not.

There are, however, at least three caveats to this analysis. First, the analysis refers to only a tiny part of the Indian economy, so the changes are small relative to the problem. The state data put organised sector industrial employment at about 7 million in 1994/5, equal to perhaps, 1.2% of the feasible work-force. Even counting informal jobs, manufacturing accounts for only perhaps 6% - 7% of potential employment. Thus even a rapid rate of expansion of such jobs will take a very long time to absorb a significant share of the remaining workers. In the meantime, as Ravallion and Datt (1996) show, urban growth does very little for the rural poor, so we should expect few spill-overs.[10]

Second, not only is the sector affected by liberalisation relatively small, but so too are the proportionate effects it experiences. Increasing job growth from 3% over three years to 9% is worthy, but it is not the stuff of great reforms. This tepid performance probably reflects the tentative nature of reform process, whereby significant areas of regulation have remained and there was a (well-justified) perception that reversals were possible.

## *4.4 Perceptions of Liberalisation*

The third set of caveats is that plenty of people in the formal sector have, or feel that they have, failed to benefit from the process of liberalisation. As already noted, TUs and NGOs are fairly hostile. Interviews with workers revealed, perhaps not surprisingly, a desire for higher wages and better conditions while few employers would admit that things have got better since 1991. We interviewed small samples of workers, employers and industry association personnel in five (formal) sectors: diamonds and gems, ready-made garments and agro-based food, as sectors expected to have gained from liberalisation, and ceramic glass and plywood as potential losers. The only positive perceptions were in gems and agro-food in which a *sub-set* of commentators admitted that exporters were better off.

These interviews warn us that, at the very least, attitudinal survey results must be interpreted with some sophistication. Workers in the 'gaining' sectors reported earning Rs 20,000 - 48,000 p.a., compared with opportunity wages of Rs 15,000 - 24,000 if they remained in their villages, and poverty-lines of around Rs 10,000, see table 4.2. They also had opportunities for moon-lighting with which to supplement their incomes. Many had been employed for several years and were able to devote a sizeable share of their income to educating their children.[11] They typically recognised that they lacked the skills for promotion to higher paying jobs within their current sectors. All this might seem to indicate that, on objective grounds, they had a reasonable deal. Yet there was widespread dissatisfaction with wages and conditions, and implicitly, one presumes, a feeling that liberalisation had not yielded much (enough).[12] Clearly one must recognise the genuineness and depth of workers'

[10] Ravallion and Datt's results strongly suggest that it is unfortunate that there has not been greater liberalisation in agriculture.
[11] For many, employment dated back to the early nineties, during which period these sectors boomed, quite possibly because of trade liberalisation.
[12] The question was not asked directly.

perceptions, but equally clearly there is another side to the story that emerges from the quantitative data collected.

The workers in the 'losing' sector had similar complaints about wages and conditions to those in the 'gaining sectors', but their other answers did suggest that they faced a harsher environment. They were much less forthcoming about their actual and opportunity wages. Many had been "pushed into" work to support their families, and few had opportunities to earn extra income. Most reported spending little on education, although apparently because, with predominantly 5-13 year old children they used government assisted schools, rather than for income-related reasons.

## *4.5 Segmented Labour Markets*

While employers reported no difficulties in getting unskilled labour, both they and employees said that recruitment was primarily by word of mouth and personal contact.[13] In the case of migrant labour - apparently a high proportion of the total - firms recruited mainly from particular rural villages. While personal contact is consistent with a unified labour market and it is, in fact, important even in highly developed economies, it will tend to slow down equilibration.

More revealing of *de facto* market segmentation is the way in which workers identified their own prospects so closely with those of their firms or sectors. Workers in the strong sectors reported having been recruited in a boom a few years ago and then sticking with their firms despite subsequent low growth of earnings. Workers in strong sectors could moonlight, very commonly in the same sector, while those in weak ones could not. Since these are unskilled workers it is presumably something other than sector-specific skills that tends to lock them in although there may be some firm-specific skill dimension.

The surveys of the losing sectors also suggested that informal institutions and trades unions help displaced workers find alternative jobs, usually in the same sector. While desirable from a humanitarian point off view, this observation is also consistent with labour-market segmentation, whereby workers identify with particular sectors and turn-over into and out of sectors is much lower than gross turn-over.

These results - which we do not seek to explain, but accept at face value - suggest that trade liberalisation has a rather unequal impact. Workers in favoured sectors gain wage increases, while those in disfavoured sectors suffer. Since workers apparently can not switch readily between sectors, the classical mechanism of mobility ensuring the existence of only a single unskilled wage is frustrated. Finding a means to integrate the labour market more fully would contribute strongly to ensuring that the benefits of trade liberalisation are more widely spread.

[13] Skilled labour is quite a different matter, both in method of recruitment and scarcity.

### 4.6 *Labour Market Segmentation in Bangladesh*

Trade liberalisation has been underway very effectively in Bangladesh for over a decade, and yet it, too, has failed to cure poverty. Labour market segmentation is, again, a substantial reason. Bangladesh's huge export response to trade liberalisation has been mainly focussed on ready-made garments (RMG) and shrimp farming. Neither has increased the demand for rural unskilled male labour, however, nor for the workers displaced by the decline of the jute industry: 80% of the workers in RMG are female, as are a high proportion in shrimp. Because they lack the required skills, rural workers are argued to be unable to access urban jobs (CUTS, 1999, Chapter 6), with the result that rural GDP has grown much more slowly and real wages have increased much less in rural than in urban areas. These data are also reflected in high rates of unemployment and low participation rates, and in the poverty statistics, with the urban percentage head-count falling from 41% to 26% between 1983/4 and 1995/6, while the rural index has fallen only from 54% to 51%.[14]

## 5. Trade and Poverty – the Policy Implications

The discussion above suggests that trade liberalisation has both positive and negative effects on poverty. Clearly if poverty alleviation is a major goal of national policy, it is important to think how international trade policy can be harnessed to assist it. This section briefly considers some of the issues involved. It does not deal with the trade-off between poverty and other goals, but it starts by noting that even within the poverty arena trade-offs exist.

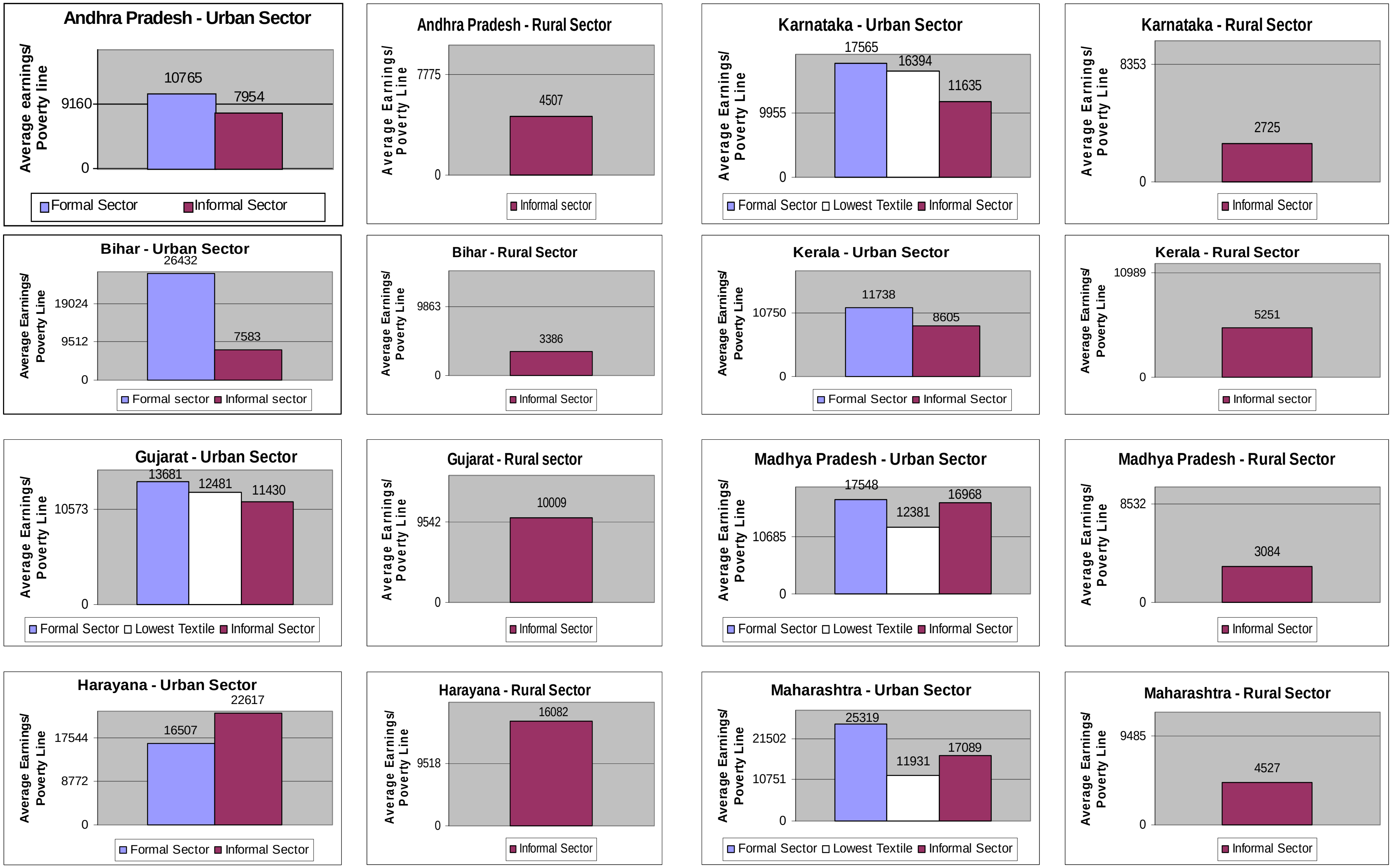
### 5.1 *Judging Policy*

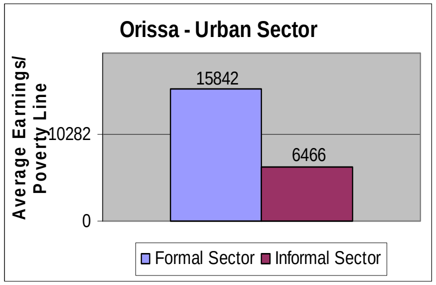
If one is to enter the policy debate, one needs to define the criterion for judging trade shocks including liberalisation. If it is to condemn any shock that causes even one individual suffer a reduction in income, it is unnecessary to carry out any analysis. Given the heterogeneity of households and the strongly redistributive nature of trade policy, all policies will fail this test. Even the requirement that no household fall temporarily into poverty is likely to be too restrictive in poor countries. The more utilitarian view that the number of households (or persons) in poverty should be reduced is more appropriate. Even this, however, needs to be mediated by attention to the depth of poverty and to the different ways in which different dimensions of poverty respond to shocks.

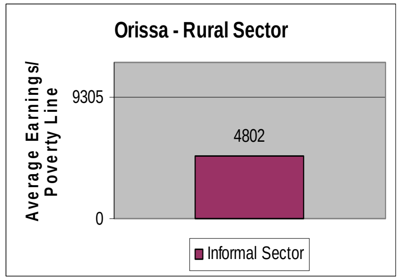
In practical circumstances, it is also useful to recall that it is easier to identify losers from trade policy than potential gainers. Losers are identifiable, concrete and personified - Krueger (1990) - whereas the gains are diffuse and appear merely prospective and theoretical. For this, and other reasons, losers will usually be better able to articulate their interests than gainers, so the volume of opinion is not a sufficient indicator of the relative strengths of the pluses and minuses of a policy change.

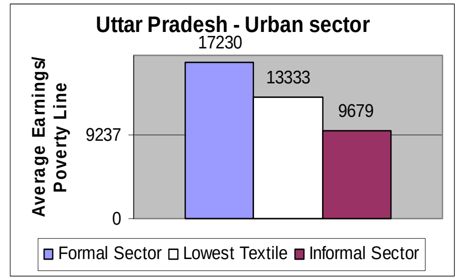
[14] In both cases absolute numbers of poor have risen.

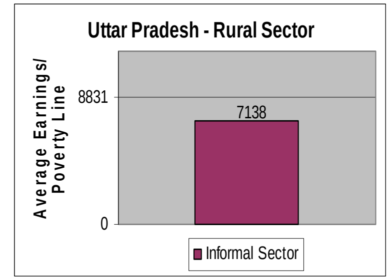
**Figure 4.2 Wages and Poverty Lines by Indian States (Rs, 1987/8 prices)**

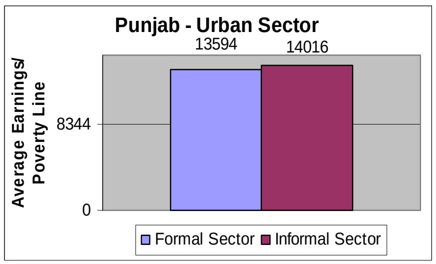


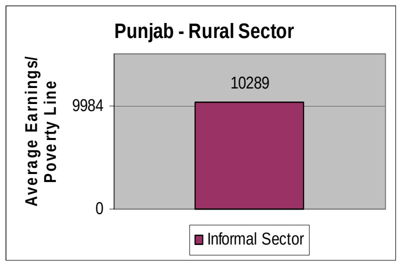

Orissa - Urban Sector
Average Earnings/ Poverty Line
15842
6466
10282
0
Formal Sector
Informal Sector

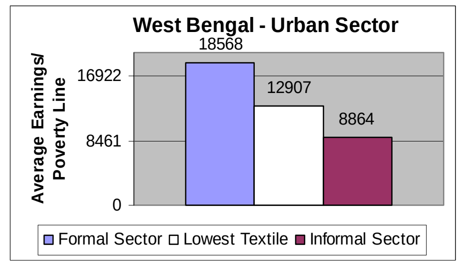

Orissa - Rural Sector
Average Earnings/ Poverty Line
9305
4802
0
Informal Sector

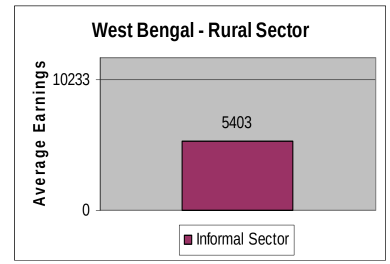

Uttar Pradesh - Urban sector
17230
13333
9679
9237
0
Average Earnings/ Poverty Line
Formal Sector
Lowest Textile
Informal Sector

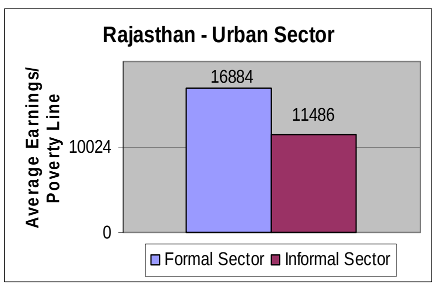

Uttar Pradesh - Rural Sector
Average Earnings/ Poverty Line
8831
7138
0
Informal Sector

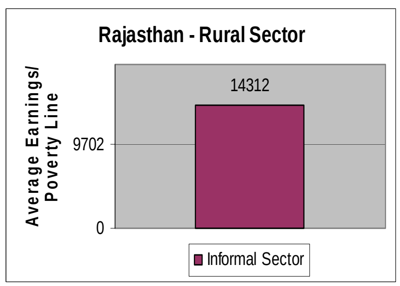

Punjab - Urban Sector
13594
14016
8344
0
Average Earnings/ Poverty Line
Formal Sector
Informal Sector

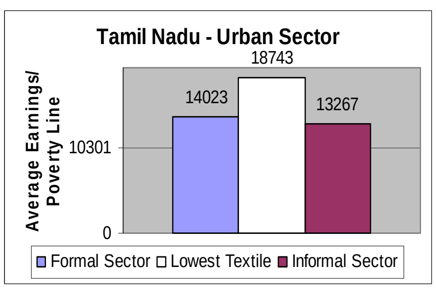

Punjab - Rural Sector
Average Earnings/ Poverty Line
10289
9984
0
Informal Sector

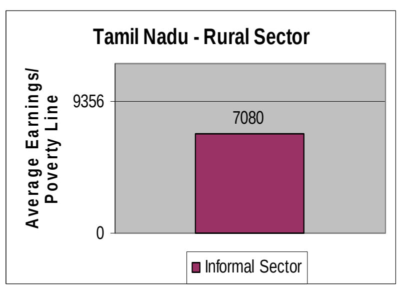

West Bengal - Urban Sector
18568
16922
12907
8864
8461
0
Average Earnings/ Poverty Line
Formal Sector
Lowest Textile
Informal Sector


West Bengal - Rural Sector
Average Earnings
10233
5403
0
Informal Sector


Rajasthan - Urban Sector
Average Earnings/ Poverty Line
16884
11486
10024
0
Formal Sector
Informal Sector


Rajasthan - Rural Sector
Average Earnings/ Poverty Line
14312
9702
0
Informal Sector


Tamil Nadu - Urban Sector
18743
14023
13267
10301
0
Average Earnings/ Poverty Line
Formal Sector
Lowest Textile
Informal Sector


Tamil Nadu - Rural Sector
Average Earnings/ Poverty Line
9356
7080
0
Informal Sector

## 5.2 Trade Policy

Consider, first, how trade reform itself should be managed from a poverty perspective. One response to the fear that a trade liberalisation will cause poverty is "don't do it", but this is not satisfactory. While it has proved hard to isolate the effects of liberal trade on economic growth empirically (see, recently, for example, Rodriguez and Rodrik, 1999), there is widespread agreement that it has an important role to play. It not only brings advantages itself but also as one of a constellation of polices designed to ensure efficiency and competition in markets and transparency and predictability in policy-making. Thus in the long run liberal trade assists poverty alleviation and should figure in the poverty-conscious government's armoury.

Another response is "don't do it all: while everyone is in favour liberalisation in general, certain sectors or products should be exempt". In fact, all countries have such exceptions – e.g. agriculture in Europe, clothing in the USA – but that does not necessarily make them good economics. There undoubtedly are cases where an isolated intervention in trade would be beneficial to immediate economic welfare and/or to poverty alleviation. However, given the difficulty of identifying these cases, of preventing their capture by interest groups and of avoiding the systemic signal that lobbying for intervention pays, it is not clear that it will be beneficial overall to pursue them. Thus while one does not need to progress all the way to free-trade to reap the benefits of liberalism, the case for planning a series of exceptions is not strong. One needs very strong evidence of the efficacy of such interventions, which is, on the whole, missing. Simply appealing to the experience of East Asia is not persuasive. It is not beyond dispute that their trade interventions were important or beneficial (Lee, 1995, suggests the very opposite for Korea), and it is far from certain that other countries have the policy-making institutions to be able to replicate East Asian policy stances effectively.

A third response is "don't do it now". This is a more useful response in some circumstances. For example, trade reform in the midst of recession seems likely to suffer more, and more durable, transitional unemployment than reform in a boom; where investment is necessary to allow the production of export-quality goods, time may be desirable to permit it to occur. There is, however, a world of difference between committing to policies with long adjustment periods and postponing liberalisation because 'the time is not ripe'. The key is credibility that reform will actually occur. Adjustment costs may be lower if adjustment can be spread somewhat through time, but they are probably enlarged if adjustment is resisted in the hope that the threat of liberalisation will go away. It is notable that quite a lot of trade reforms have been accelerated once they have been launched – e.g. implementation of free trade in the EEC, of the Kennedy Round tariff cuts, and of the tariff cuts planned in the ASEAN Free Trade Agreement - usually at the behest of the private sector. This presumably reflects the fact that, once it is accepted that reform will occur, business is keen to adjust rapidly.

Thus sequencing a major trade liberalisation is probably desirable – just as, say, the Uruguay Round permitted long adjustment periods. This should not merely entail postponing the largest adjustments longest, but should pay attention to the different adjustment needs of different sectors and to the interactions between different parts of the package. For example, if the inputs and outputs of a particular sector are liberalised at very different rates, the sector could face either negative or excessively positive incentives for production during the transition[15]. Whatever the transition period, credible commitment to the final goal is important, for without it neither current nor potential future activities will look desirable and there will be a diversion of effort into lobbying.

## *5.3 Specific Compensatory Policies*

If trade liberalisation causes poverty among certain sections of society, a natural response is to ask whether society can not offset the effect directly. Despite their theoretical attractions for economists, governments are not generally attracted to lump-sum budgetary transfers because of their cost, their transparency (and the transparency of their abuse) and the appearance that they do little to cure 'the problem' that the individuals face. Rather assistance is usually offered, if at all, in terms such as retraining, relocation assistance, and temporary income support. In fact, while they probably do have a contribution to make, even these approaches face severe difficulties. Official retraining has mixed success under any circumstances; worse, there are problems in separating those cases where trade is to blame from those where it is not. Thus unless one is willing to underwrite almost any adjustment, identification of cases is a major difficulty. Making a general commitment, however, is not attractive because of the potentially huge cost and because doing so shifts private risk to the public sector, with all the attendant moral hazard problems. It is not the role of the state, nor is it feasible, to absorb every negative shock that might afflict individuals. On the other hand it is difficult to make a moral case as to why trade shocks warrant adjustment assistance while other do not.[16]

A further complication is giving compensation in a way that encourages rather than discourages adjustment. European agricultural policy is essentially designed to protect farmers from the consequences of declining comparative advantage, and yet it has the effect of rewarding current not ex-farmers. Compensation may be decoupled from current output, but not from farming as an activity.

In cases where liberalisation leads to the loss of jobs, government can insist on, and perhaps help to finance, redundancy payments. These can help some people to avoid poverty, if they use their money productively, but is not guaranteed to do so – see above on the so-called 'new poor' in Zimbabwe. Moreover, redundancy payments typically reward past service not current need and so are not particularly well targeted for poverty purposes.

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[15] Technically, the effective rate of protection (ERP) could become very distorted. In Zambia, Oxfam-IDS found decreases in the ERP for maize, as fertiliser prices (which apparently account for 76% of the cost of production) increased by more than output prices. This accounts for the loss of output there.

[16] See Decker and Corson (1995) on the USA's Trade Adjustment Assistance Program. This doubles unemployment insurance cover from 26 to 52 weeks for workers certified as displaced by trade liberalisation. After serious abuse in its early years when it was merely a transfer – over 70% of claimants went back to work for the employer from whom they were said to have been displaced – a training element was added. This had the effect of screening out claimants who did not want/need training, but apparently did nothing to increase the earning power of recipients.

## *5.4 General Compensatory Policies*

These policies – often referred to as safety nets – are designed to alleviate poverty from any source directly. They replace the problem of identifying the shock with one of identifying the poor. Ideally, countries should already have such programmes in place. Indeed, a major part of their effect arises from their mere existence rather than their use: they facilitate adjustment by assuring the poor that there is a minimum (albeit barely acceptable) below which they will not be allowed to fall. If trade-adjusting countries do already have these schemes, they have the advantages over tailor-made schemes of automaticity, immediacy and a degree of 'road-testing', and they also avoid the problems of targeted trade adjustment assistance. Sensibly constructed, they need not entail huge expenditure; there is rather little chance of moral hazard problems if the thresholds are set low enough; and, since relieving poverty is more or less universally recognised as a responsibility of the state, there is little argument about the legitimacy of such interventions.

Targeting is a major problem for safety nets, for the middle classes are often better able to access them than the poor. Moreover, a major trade shock could put severe financial pressure on them. However, Ravallion (1999) offers some useful thoughts on setting them up. Workfare is a good start, provided that the wage is low enough, that there is little or no administrative discretion in its application, and that the tasks set are seen to be of communal interest. In fact, Ravallion suggests that local communities select the projects to be undertaken under workfare and that the richer ones should also be asked to co-finance them. Workfare needs supplementing, however, by schemes to provide food to people such as the elderly and infirm who cannot work, and for children –e.g. food-for-education schemes. These supplementary schemes may be tripped on and off according to need, but should have a permanent infrastructure and sensitive and quick triggers. Expenditure on safety nets is almost by definition counter-cyclical, and so it will need firm commitment by government to ensure that the money does not dry up in times of greatest need.

Examples of safety-nets are many, but among our study areas those in Bangladesh were found to be useful: "It is generally recognised that programmes such as Food for Education (FFE), Vulnerable Group Development (VGD), Test-Relief (TR), Food for Work (FFW) etc. positively induce alleviation of poverty. For example, during the unprecedented floods of 1998, about 4.5 million VGD cards were distributed in Bangladesh, which provided crucial help at a critical time. The FFE programme has helped increase school attendance of poor children by 21%." CUTS (1999, chapter 6). Those in Zambia and Zimbabwe, on the other hand, are currently regarded as too poorly run and under-funded to be able to offer serious mitigation to the losers from trade liberalisation.

Safety nets can not be the only response to the threat of increasing poverty from trade liberalisation, but, they are an important part of it. They can generally be better targeted than other polices and they are not very distortionary of market forces. If countries do not have them already, they should consider setting them up as part of the context for a trade liberalisation that may create short-term poverty. They should not, however, be trade shock-specific.

## *5.5 Complementary Policies*

Complementary policies are those, which it would be useful to have in place or to implement simultaneously with a trade liberalisation. They are not compensatory, but are rather designed to ease the adjustment strains and help households avoid poverty by allowing them a greater degree of economic viability. Strictly, these policies include very general prescriptions for addressing poverty, such as the distribution of productive assets, adequate education and health provision, and the encouragement of civil society and participation and voice among the poor. However, we restrict our brief discussion to those that refer rather specifically to reaping the benefits and avoiding any costs of trade liberalisation.

The critical issue in the poverty impacts of trade liberalisation, especially for surprises therein, is the functioning of markets. A trade liberalisation needs to be preceded by thought about whether any markets are likely to fail and accompanied by monitoring of the same. Policies designed to ensure that markets continue to function or develop where required seem likely to have high pay-off for both aggregate income and poverty alleviation. Among the important factors arising from our discussion above are:

**Infrastructural Support**

Potential opportunities for poor producers to benefit from a more open trading regime have been lost because critical infrastructure was either absent or had deteriorated. In both Zimbabwe and Zambia remote farmers have found their opportunities constrained by an inability to reach major market centres. In the same way, many of the benefits of relaxed retailing regulations and the availability of new and/or cheaper goods have been confined to urban and peri-urban areas.

**Market Institutions**

Just as important are failures in market institutions. The poor frequently seem unable to attain the economic mass required for the establishment of markets that once established may be viable. Our fieldwork uncovered several examples of external assistance in creating markets that could provide a useful model – see Box 5.1. Policy should aim at the creation of the market as an institution, not the ongoing subsidization of market activity. Part of facilitating the poor's participation in markets may be finding means to allow them to combine very small consignments of inputs or outputs into reasonably sized bundles. This is not the poor combining to achieve a measure of market power, which is not usually realistic, but of reducing transactions cost sufficiently to make it worth dealing with them.

**Missing credit markets**

Development economics has many examples of missing credit markets preventing development, and the same phenomenon is visible in responses to trade liberalisation. Thus, for example, achieving minimum consignment size might entail hiring draught power or seasonal labour, but this is not possible without credit. Similarly, establishing informal businesses in areas such as trading may require more capital than the poor can raise. These cases in which poor can respond less strongly to incentives than the less poor replicate the results of Lopez, Nash and Stanton (1995) in their panel study of Mexican agriculture. We have nothing to add by way of solutions, but note the issue as one of considerable importance.

**Labour mobility**

The secret of spreading the benefits of increasing labour demand widely is labour mobility. If markets are segmented for cultural or geographical reasons breaking down these barriers through information and facilitating physical mobility will be equalising in effect.

**Box 5.1 Creating Markets in Africa**

The IDS-Oxfam fieldwork in Africa turned up several examples of external assistance in creating apparently viable markets of use to the poor. For example:

**Horticulture in Zimbabwe**

Whilst horticulture is relatively underdeveloped in most of the smallholder areas, an increasing number of resettled and communal households are now becoming involved as producers of the main crops. This has primarily been the result of ‘Outgrower’ schemes and the sourcing or subcontracting by the large-scale commercial farms. The Horticultural Promotion Council (HPC) estimates that around 3,000 smallholders are now growing for export on a contract basis, accounting for approximately 10% of Zimbabwe’s exports[17]. The HPC established the Smallscale Linkage Programme in January 1999, designed to provide communal and resettled farmers with the knowledge and skills to produce high-value, out-of-season export crops. Quality is a critical issue. Our visit to Mbare fruit market demonstrated that communal and resettled farmers sold limited amounts of produce to Harare Produce Ltd., and the remaining (deemed as ‘sub-standard’) to the local market.

**Craft products**

Women interviewed in the Sese communal area, involved in the production of pottery, were being linked to European markets through the Craft Enterprise Programme executed by the Rural Unity for Development Organisation. The programme covers more than 165 households. In addition to servicing the export market, the women were trading in the domestic market to tourist resorts and along the major roads. They noted significant growth in the export sales of pottery, which enter duty free in the European and USA markets. An added incentive for sales to these markets, is that the buyers meet the cost of transportation. Annual income for these women was very low, even by subsistence standards, but it is still a useful supplement to their households.

[17] These small-scale ‘outgrowers’ tend to supply the four main pack-houses in Zimbabwe, which are the large-scale producers looking for added volume and to diversify risk.

**Establishing business**

If trade liberalisation opens up business opportunities in new areas, new businesses are likely to be required. If the regulations for establishing these are restrictive, and their ability to get inputs (especially utilities) weak, these opportunities will go begging. Similarly regulations on expansion and on labour recruitment and separation could curtail the willingness of existing firms to expand. The reservation of particular sectors for small firms in India may be having this effect. There is clearly a trade-off between labour protection and the number of jobs, but we suspect that for the purposes of poverty alleviation it will call for weaker rather than stronger protection. A success story of business de-regulation is the growth of maize hammer milling in Zambia and Zimbabwe – see Box 5.2.

**Training workers**

Both employers and workers in India argued that the training market was failing – employers because they could not find skilled labour and workers because the employers would not provide or pay for training. In a sense this is just a credit market failure – economic theory suggests that mobile workers will have to pay for their own training - but it may be that a public response in terms of providing training facilities is a feasible second-best response. Care is necessary, however, to avoid problems such as providing inappropriate skills and merely financing periods outside the active the labour force.

**Pre-requisites or Concomitants?**

Whether these complementary policies should be pre-requisites for or concomitants of trade liberalisation remains a contentious issue. While there is a literature on sequencing reform within the trade sector and between trade and capital accounts, there are no convincing empirical generalisation about sequencing in the sense discussed here. There may be a case for delaying liberalisation by a few months while some of the legislation on business and labour is put in place and plans for protecting market institutions laid. My own view, however, is that any further delay will be interpreted as a reluctance to liberalise trade and will send completely the wrong signal.[18] A credible plan for liberalising the borders – albeit one with significant transition periods - will be an important stimulus to reforming these other areas in ways that will typically have other benefits as well.

[18] In particular, in the absence of a clear and monitorable plan for specific pieces of infrastructure, a general wish to wait until the roads or ports are 'ready' is just a recipe for indefinite postponement.

**Box 5.2 Competition through Entry: Hammer-mills**

Domestic trade deregulation has created many new opportunities for small-scale agro-processing, particularly within the maize sub-sector. For example, in Zimbabwe 3 500 new hammer mills have opened up since liberalisation, mainly in the rural areas, and the share of hammer millers in total maize milling has increased to almost 80%[19]. These mills are mechanically simple and robust (being based on swinging or rotating hammers in a grinding chamber), and can be used by unskilled labour. They provide quality maize meal products to nearby customers in the poor communities in areas such as Mashonaland Central, Manicaland, Masvingo, and Matebeleland North and South, saving them significant transport costs.

The hammer mills have provided a new source of livelihood in both Zambia and Zimbabwe. In Zimbabwe hammer mills were estimated to employ 7,512 permanent workers (751 in urban areas); including casual workers, the sector employs a total of 10,000 workers; and if hammer mills in commercial farming areas are included, this takes the total to 12–13,000 workers. About 18% of employees in urban hammer mills are female and 8% are located in rural areas (*ibid.*).

Indeed, large-scale millers in Zimbabwe are now believed to have a combined market share of only 20–25% of maize meal trade. According to *The Herald* newspaper (6/6/97), one large-scale commercial miller is reported to have closed six of its nine milling plants around the country, in response to the intensified competition provided by the new small-scale millers. Whilst poor producers have benefited from this opportunity, so too have poor consumers.

## 6. Poverty and World Trade Negotiations

The greatest effects of trade policy arise from what a country does to itself rather than what others do to it. Thus most of what developing countries need to consider in terms of future trade talks is covered above. They should consider their potential offers of liberalisation and the requests made of them in the terms explored above, as well as in terms of aggregate output, sectoral profits, and so on. However, by definition a negotiation also entails other countries undertaking action and it worth thinking how this might be assessed from the point of view of poverty alleviation.

It is also worth pointing out that a negotiation is a compromise and, whatever they might say publicly, it is not realistic for developing countries to believe that they should do nothing which taken in isolation would harm them or increase poverty. The relevant criterion is the value of the overall package, not the absence of negatives on individual accounts. It is also important to realise that different developing countries will have very different interests in the negotiation, and thus that any advice given here or elsewhere needs careful tailoring to individual circumstances.

[19] The USAID-funded 1995–96 *Zimbabwe National Hammer Miller Status Study.*

This section deals with a few of the issues very briefly. However, the topic of the trade negotiations and poverty requires much more serious and extensive work than can be appended to the present exercise, and for that reason DfID has commissioned further work on the subject from the present author.

The Uruguay Round mandates discussions of services and agriculture this year, plus several reviews, including on intellectual property. Thus despite the failure of the WTO's Seattle Ministerial Meeting in December 1999 to launch a round of talks, some of the topics listed here are still current. Moreover, the remainder of them are likely to be included in the future round that many hope to see launched before the end of 2001. Wang and Winters (2000) considers a future round from the overall (rather than just poverty) perspective of developing countries.

**Agriculture**

In terms of what industrial countries should be asked for, agricultural liberalisation is probably the most important contribution towards alleviating third world poverty. Increased demand for agricultural exports, plus possible increases in the prices thereof, would almost certainly boost rural incomes and, on the evidence here and elsewhere (e.g. Ravallion and Datt, 1996 and Mellor, 1999) contribute strongly to a broad based alleviation, possibly in the cities as well as the countryside. Agricultural liberalisation requires effective, not merely nominal, market access for developing country produce. This requires solutions to the difficulties posed by sanitary and phytosanitary regulations, including transparent administration and assistance in setting up certification procedures that facilitate access. A worrying, and potentially poverty-increasing, trend from the last few years is that industrial country firms have focussed their buying increasingly on large and established suppliers, because only they can give the required quality assurances – see Oxfam-IDS (1999). And the situation is likely to get worse as pressures for ethical trade grow. Solving this problem will require cooperation between firms, governments and farmers; it could well be an area in which technical assistance and temporary grant financing would be well rewarded.

Of course, rising food prices ring alarm bells for the urban poor and for food-importing countries in general. In a significant number of cases, however, countries import food only because of the distortions in their own agricultural policies, and a decline in imports would actually be welfare enhancing overall. Their response should be to reform their own agriculture at the same time as the industrial countries do. The urban poor do fare more serious problems. Ensuring competition in food markets, making provision for local markets to emerge, and emergency feeding provisions all have a role to play, but so too does a public information campaign stating that the subsidisation of urban wages by rural residents and the world community is not a sustainable position.

**Industrial Products**

The abolition of the MFA is due by 2005. This does not look entirely secure, but developing countries should insist upon it, and then seek to capitalise on it by requesting reductions in tariffs on clothing imports into industrial countries. This seems likely to help to alleviate poverty in labour abundant countries – e.g. South Asia – provided sensible policies are put in place for inputs and the establishment of firms. Attention is necessary on the gender aspects of the resulting expansion, however. Similarly, footwear and leather goods probably offer scope for liberalisation that would reduce poverty.

Africa will probably lose from the abolition of the MFA because it will no longer benefit from cheap clothing imports diverted from closed markets. In the future, however, removing the threat of constraints on their exports will be beneficial – e.g. Martin and Winters (1996). This will help urban poverty there, but does not address the quantitatively more important issue of rural poverty.

**Services**

Services liberalisation offers considerable scope for economic benefits for developing countries, in terms both of exports and imports. The direct effect on the poor seems likely to be rather small, however. They consume few services and so benefit only slightly from the lower prices induced by freeing imports and the contribution of the wholly unskilled to exports is also probably rather small. However, there would presumably be some spillover in terms of non-specific jobs in service exporters (e.g. cleaning) there are potential poverty benefits from the general increase in prosperity that that services liberalisation could induce. The critical sectors for developing countries are maritime services, construction and, across sectors, the movement of natural persons. Overall, however, we would see services as a less direct approach to poverty than are agriculture and simple manufactures.

**TRIPs**

TRIPs is an emotive issue and one on which the evidence on the long run is very far from clear. However, in the review that is required by the built-in agenda of the Uruguay Round, developing countries might usefully seek a more sympathetic clarification of their rights in relation to traditional goods and remedies and in relation to compulsory licensing in pharmaceuticals. These may affect the poor by reducing drug costs and by raising government revenues from royalties, but again the effect is more indirect than direct.

# 7. Conclusions

This paper has summarised a research programme supported by DfID, UK to investigate the links between trade liberalisation and poverty. It has considered, in order, the predictions of the theoretical literature, a grass-roots perspective from two African countries, an econometric study and labour market survey from South Asia, and the policy implications both for countries' own liberalisations and their participation in future world trade talks. Methodologically, the programme has stressed the need to hear from actors on the ground as well as to consider more formal statistical sources.

In nearly everyone's book, openness and trade liberalisation are important components of development policy. Open economies fare better in aggregate than do closed ones, and there is no evidence that, overall, they experience worse poverty than closed ones. Indeed, the evidence is just the contrary: trade liberalisation is found generally to increase economic opportunities for consumers and producers and to raise earnings for workers. On the other hand, it is absurd to pretend that liberalisation never pushes anyone into poverty, nor even that liberalisation can not increase the extent or depth of poverty in some circumstances. Thus in contemplating and managing a liberalisation care is required to minimise adverse poverty impacts (care that has not always been taken in the past), and, wherever possible, to tailoring reform to play a positive role in poverty alleviation.

One of the lessons of theory is that because the poor are so heterogeneous within a country and because poor countries differ so much among themselves, it is not possible to devise universal formulae for managing liberalisation. However, the experiences analysed in the DfID programme suggest some robust lessons.

First, poverty, and especially poverty that was not predicted, arises primarily from market failure. Most dramatically, domestic deregulation of cash crop purchasing can leave remote farmers without buyers, precipitating them into poverty. In Zambia, some of these farmers found it difficult to return to the subsistence farming that they had practised prior to growing tradable maize, because they had lost the seeds and the skills necessary. Even where private buyers are operating it is important to ensure that they do so competitively, as the contrast between Zimbabwe and Zambia illustrates.

The poor cannot always take advantage of the opportunities that liberalisation creates because they lack either the skills or capital. For example, in Zimbabwe the growth of small-scale trading seemed not to include the very poor, and in Zambia farmers switched from maize to cotton despite the latter's poor returns, because cotton purchasers provided inputs and credit. Farmers' inability or unwillingness to cope with fluctuating prices restricts the advantage they can take of liberalisation; this inability could arise from credit market failure, although we have no direct evidence that it does so.

Predicting, allowing for and correcting these various market failures is the most important of our policy lessons.

Second, market segmentation seems likely to prevent the benefits of liberalsiation from spreading as widely as possible. The evidence of labour markets in South Asia suggests that, despite an almost unlimited supply of unskilled labour, demand shocks partly impact wages in the formal sectors in which they occurred rather than being dispersed over the whole labour market. Given that formal wages already appear to exceed poverty levels, while many informal ones do not, greater integration which would allow shocks to be entirely absorbed by employment change would be better for poverty alleviation.

Third, liberalisation can have uneven effects within households. The growth of clothing exports in South Asia and the decline of manufacturing jobs in Africa have both put more strain on women and there is a suspicion that they have not been fully compensated within the family. Policy makers need to allow for this unevenness in preparing for liberalisation and managing its consequences.

Fourth, the obvious bears re-iteration: the effects of liberalisation depend on what you are liberalising. In Zambia and Zimbabwe, protection for manufacturing has declined significantly. It is not surprising that, except for food processing which benefited from the agricultural liberalisation, output declined. Maybe more surprising to some, is that in some sectors it may be starting to recover after a few years. In India liberalisation has largely missed agriculture and so it is not surprising that rural poverty has been largely unaffected by the process.

Fifth, perceptions of liberalisation on the ground do not always accord with the evidence available from formal statistical sources. We found conflicts in both India and Africa, with, perhaps not surprisingly, the perceptions being less sanguine than the statistics. This suggests that one needs to be cautious in interpreting any single source of information on the evolution of poverty.

Finally, the liberalisations in Africa and India have been partial and recent. Our fieldwork has just not covered many of the potential problems identified in theory. The latter can not just be dismissed for this reason, however: for example, has openness exposed the economy to shocks that generate uncertainty, or undermined policy measures designed to alleviate poverty and redistribute income? The future research agenda in this area is huge.

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