

“Trade and Poverty Linkages Study”

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1. Introduction.

1.1. The purpose of the paper

This paper presents a framework of analysis for examining the impact of changes in trade regimes on poverty. It aims to guide research undertaken in case study countries as part of the Africa Trade and Poverty Programme (ATTP) and we hope that it will result in the development of a robust and empirically based understanding of

- how reforms and economic events interact and impact on growth, the distribution of such growth and its effects on poverty and well-being;
- what the key impacts on a range of sectors (including agriculture and manufacturing) have been or are likely to be.

One of the premises underpinning this research is that policy matters, that trade policy affects trade, and trade then has effects on poverty, for example through effects on economic activities in which poor people participate, through effects on the prices that they pay for goods and services, and through effects on government taxation and expenditure, which in turn affects their entitlements from government. Sheila Page (2003) points out that there are three views of markets and development which underlie people's views of increasing access to markets:

- It *will* help a country develop and reduce poverty
- It *can* help a country develop and reduce poverty
- Increased access to markets normally will not benefit development, and it has to be modified, by policy or other intervention, to correct the normal negative consequences

Another premise is that it is difficult to mitigate negative effects of changes in trade through administrative targeting and social policy. Therefore analysing the first round effects of trade changes acquires additional importance.

We take as a starting point that opening up a country's markets to a greater volume and range of traded goods and services and easing restrictions on exports will generate both positive and negative direct and indirect effects. We acknowledge that segments of the population and sectors of the economy will be differentially affected over the short, medium and long term. These effects may intensify the poverty of one group of people over the short term, while decreasing the poverty of another over the longer term.

Identifying the direct effects of trade policy on poverty may be possible (a change in tariff affecting a basic good like mosquito nets, for example), but it is complicated by the different magnitude and speed of changes in trade practice and whether they are generated by economic causes or policy changes. Also it is not always clear what the outcomes of a specific policy will be. They depend, in part, on the effectiveness of implementation as policy does not translate automatically or seamlessly and faultlessly into action. Implementation processes can be highly flawed, and it is policy as experienced through *real* changes in action, rather than policy as documented, that we are interested in.

1.2. The structure of paper

The main body of this paper introduces topics which are examined in greater detail through the Checklist (Annex 1) and Matrix (Annex 2). The Checklist and Matrix

provide the ideal range of issues that would be considered in an in-depth trade-poverty linkage study. However, the range of issues and the depth with which researchers examine them will depend on the time and financial resources available, and the availability of studies and data from which they are able to draw their analysis. The starred items in the Checklist (Annex 1) are considered to be priority issues, particularly for examining first round effects.

In Section 2 we present a number of approaches to defining poverty and highlight the importance of a good quality poverty and social analysis. We highlight the importance of differentiating the poor by the severity of their poverty, by their location (e.g. spatial concentrations of poor people in remote rural areas, urban slums, low potential rural areas etc.), by the duration of their poverty (transitory versus chronic) and by their social identity (e.g. ethno-linguistic group, gender, disability). In Section 3 we outline the importance of the nature of poverty in terms of its affect on trade and trade policy.

In Section 4 we present an analysis of trade effects, and outline the possible relationships between a range of trade and macro-economic policy instruments and poverty, e.g. import taxes and tariffs. We then move on, in Section 5, to assessing how changes in trade regimes can affect the poor. This section includes an overview of the debates surrounding trade liberalisation and economic growth, and an examination of whether increased trade flows increase income differentiation. The section also assesses the possible impact of changes in trade on asset levels, livelihood and coping strategies¹, consumption, well-being and transfers.

Annex 1 presents a checklist of questions that researchers into trade-poverty linkages can use as an *aide memoire* when designing or undertaking research into trade-poverty linkages. Annex 2 is a matrix of issues which link trade and poverty, examples found in the literature and possible research methods for exploring such issues. In Annex 3 we suggest a range of research methods and approaches which may be useful in examining trade-poverty linkages, and in Annex 4 we present an annotated bibliography on poverty and trade issues.

2. Who are the poor?²

In this section we discuss alternative approaches to the definition and measurement of poverty. We introduce factors which may lead to high concentrations of poor people in particular geographical areas, amongst specific livelihood groups or economic sectors and amongst specific social groups (see Annex 1, Q1).

2.1. Definition and characterisation of the poor.

If we are to be able to predict how current and potential future changes in trade policy and practice will affect poverty, we need to have a thorough understanding of who the poor are, where they are located, and what the causes and dynamics of their poverty are. Traditional definitions of poverty have been income and consumption based. Measurement has followed the construction of poverty lines, which has allowed analysts to calculate the numbers of individuals or households falling below

¹ In this paper we use livelihoods to mean the diverse portfolio of activities and enterprises that a household undertakes to maintain income, consumption and well-being.

² Analysis for this component of ATTP country-study research should be based as far as possible on the existing poverty estimates and analysis in each country. Researchers are not expected to undertake primary research in this area as part of this project.

the thresholds of total consumption and food poverty. These measures are useful for comparison over time and between countries, but have many weaknesses, are incapable of generating a robust and dynamic analysis of poverty, and are no longer considered to be adequate (Kanji and Barrientos, 2002:6). More complex understandings of poverty have developed through the 1980s, 1990s and into the current decade with increased understanding of the importance of risk and vulnerability (Swift, 1989, Chambers, 1989), multidimensionality (Chambers 1983), capabilities and freedoms (Sen, 1999), and the involvement of the poor in identifying, defining and analysing poverty through participatory poverty assessments (PPAs). Good quality analysis is now expected to extend beyond income to assess a range of material and social outcomes, including assets, capabilities and vulnerabilities (Kanji and Barrientos, 2002:6), and a greater understanding of the importance of differentiating the transitorily and seasonally poor from the chronically poor (Hulme and Shepherd, 2003) means that researchers should introduce a time dimension, where possible.

A multi-dimensional understanding of poverty is important as changes in trade might have short-run impacts on one group of people which increases income while leading to an erosion of assets and long term well-being. Researchers need to view short-run changes balanced against any long-run changes, which might include slightly reduced incomes on one hand, but improvements in assets and other aspects of well-being on the other.

The table below provides a quick overview of some of the leading multi-dimensional approaches to understanding poverty, and indicates which elements of poverty it provides insights to.

Table 1: Multi-dimensional approaches to poverty compared ³

Theory Poverty Dimension	<i>The deprivation trap</i> Chambers, 1983	<i>Livelihood Framework</i> Carney, 1998	Capability Poverty Measure Sen in HDR, 1996	<i>Human Poverty Index</i> HDR, 1997	Ill-Being Chambers, HDR, 1997
Income Poverty	poverty	financial capital (?)			
Vulnerability to Risk/ Shocks	Vulnerability	Policies Institutions and Processes (?)			<ul style="list-style-type: none"> • lacking able-bodied family members who can feed the family in a crisis • having to accept low status or demeaning work • no year round food security
Physical Weakness/ Morbidity	physical weakness	human capital	<ul style="list-style-type: none"> • avoiding preventable morbidity • being well-nourished 	<ul style="list-style-type: none"> • access to health services • longevity • safe water (?) • malnourished < 5s 	<ul style="list-style-type: none"> • being disabled
Low Human Capital	physical weakness (?)	human capital		Knowledge	<ul style="list-style-type: none"> • being able to send their children to school • children have to work
Lack of Social Connectedness/ Capital	isolation (?)	social capital	<ul style="list-style-type: none"> • involvement in the life of the community 		<ul style="list-style-type: none"> • able to decently bury dead • being single parents • suffering the effects of bad behaviour (e.g. alcoholism) • being poor in people
Low Political Connectedness/ Capital/ Power	isolation (?), powerlessness	Policies Institutions and Processes (?)	<ul style="list-style-type: none"> • involvement in the life of the community (?) 		
Gender inequity	Powerlessness (?)		<ul style="list-style-type: none"> • involvement in the life of the community (?) 		
Spatial Isolation	isolation (?)				
Lack of Natural Capital		natural capital			<ul style="list-style-type: none"> • lacking land, livestock, farm equipment • being dependent on CPRs
Lack of Physical Capital/ Assets			<ul style="list-style-type: none"> • being adequately clothed (?) 		<ul style="list-style-type: none"> • bad housing
Fear of Physical Violence					

Source: Bird, 2001

³ The empty cells in the matrix indicate issues not covered by the methodology in question

Improved understandings of poverty encourages us to view the poor as heterogeneous. This allows us to deepen our analysis of how households and individuals become poor, what keeps them in poverty and what may enable them to escape. For example, while one household might have been recently driven into poverty by the illness of the main breadwinner, another might be chronically poor due to social and political exclusion (e.g. an ethno-linguistic minority group). An individual whose earning and consumption levels fall seasonally to below the national (*total consumption*) poverty line will respond differently to livelihood opportunities and the enabling environment than members of an extended family which is chronically and severely poor, and lives below the *food poverty* line with minimal assets, capitals or capabilities. So, the identification of those most vulnerable to trade-related shocks should go beyond the often weakly expressed 'vulnerable groups' which is often taken to include orphans, abandoned elderly, women headed households, people living with AIDS (etc.) to examine vulnerability to poverty by livelihood group, socio-cultural identity and geographic location.

Such differentiated understanding is necessary if the impact of policy change is to be accurately predicted. However, country-level data limitations may hamper researchers from presenting such well developed pictures of poverty, so it is important that research into trade-poverty linkages expresses clearly which approach to the definition and measurement of poverty is being adopted.

We provide further suggestions on data sources and research methods in Annex 3: *Appropriate research and data analysis methods*.

2.1.1. *Income sources*

Poor people are likely to be concentrated in particular livelihood groups. Their location may differ from country to country but is likely to include activities characterised by low barriers to entry (including skills requirements), low wages and high levels of drudgery or risk. These groups will include peasant⁴ or smallholder farmers; casual labourers (including the landless); urban industrial workers and some service providers.

A knowledge of which livelihood activities and sectors have high concentrations of poor people, combined with an understanding of the dynamics of poverty in a given economy, will provide researchers with an enhanced ability to predict the likely first and second round impacts of particular shifts in trade policy and practice. This analysis will be enhanced by a knowledge of the coping and adaptive strategies of the poor, as this will alert researchers to instances of poor households reacting to (possibly trade-induced) shocks.

2.1.2. *Social factors*

Good quality social analysis is vital to an understanding of poverty. It is important to understand how families work and how different social groups interact. Such an understanding provides the basis for being able to predict whether changes in the economy will benefit (for example) members of a specific ethnic minority group or not. Knowing which aspects of social difference (including gender, age, religion, ethnicity and language, physical and mental impairment) are linked to poverty in a particular society enables researchers to comprehend the distribution of the costs

⁴ Peasants are agricultural producers characterised by their *partial engagement* in *imperfect markets*.

and benefits associated with changes in the rules governing trade, and to predict the supply response generated by such changes (see Annex 2, Q3.1 and Q4.2).

An important element in such social analysis is the development of an understanding of what the norms are within different parts of a country (or amongst different religious, ethno-linguistic or cultural groups) governing household decision-making and the access to and control of resources.

So, social analysis will help researchers understand how changes in the trade environment will impact differentially on different groups and generate particular types of supply response (see Ashley et al, 2002d for a quick overview of approaches to household level analysis and household decision-making, and Fontana and Wood, 2000, and Fontana, 2002 for examples of a CGE model which separately models, for women and men, not only the market economy but also social reproduction and leisure).

Key actors in international trade negotiations tend to argue that trade is gender neutral. However, Kanji and Barrientos (2002) highlight the importance of disaggregating the effects of change in trade regime by gender (see Annex 1, Q2 and Q10). The inequalities affecting women, which are based on cultural norms and *de facto* legal barriers,⁵ need to be considered within the context of a broader social analysis and understanding of intrahousehold differentiation.

Despite country-specific variations, the 'feminisation of the labour force' appears to be associated with market-led growth and global economic changes (Kanji and Menon-Sen, 2001). Whether women benefit from their increased engagement in the wage labour market will depend, in part, on social roles and expectations, command over resources and patterns of discrimination. These include norms concerning the allocation of household productive and reproductive tasks. It may be that they are unable to control the money women earn and their leisure time is squeezed due to male reluctance to take on more household tasks (see Annex 2, Q4.3 and Q4.4).

In many parts of sub-Saharan Africa women are responsible for the food security of the household. The cultivation, storage and processing of certain food crops and types of livestock are their responsibility (typically poultry and sometimes 'small stock' – sheep and goats). They tend to have greater control over any cash returns from the sale of surpluses of these crops than from the sale of 'male cash crops' such as tobacco, sugar cane or coffee. Male heads of household typically allocate women with land for food production. Other land will be under male control, as will large livestock (bullocks, oxen, buffaloes) and household labour.

The supply response to new price incentives for particular crops (through reduced export tax increasing returns, or improved availability of seeds and fertilisers following the reduction in import tax) will depend on whether the crop is a 'male' or a 'female' crop. Women may want to increase or decrease production of 'female' crops, move into production of 'male' crops, or change employment, but may be constrained in doing so (Whitehead, 2001)⁶. Men may have greater freedom to increase or

⁵ Lack of inheritance rights; bars on women holding formal or *de facto* tenure of land; lack of independent access to financial services; gender-based labour market rigidities; paucity of access to education and health services intensified by gender etc.

⁶ These constraints include low levels of ownership and control of the land that they farm; poor access to credit and therefore seasonal inputs and hired labour; and variable access to and control of the returns from their labour and the sale of their agricultural products. Similar constraints are experienced by women entrepreneurs, who may find their husbands reducing their financing of household consumption in the face of women's increased income and independence (Bird and Jackson, 2002).

decrease production of certain crops in response to new incentives. For example, the promotion of non-traditional exports in Zambia benefited both women and men, but benefits were distributed according to women's and men's traditional crops. So women benefited from expanded opportunities for trading horticultural crops and groundnuts while men benefited from the promotion of tobacco and coffee (Fontana, 2002). Also, while the reallocation of resources from maize to female-intensive crops made women more productive, it was at the cost of their leisure-time (ibid) (see Annex 2, Q5.1, 5.2 and 5.3).

Changes in enterprise mix may result in a net increase in aggregate household income. However, such a change may have an unpredictable outcome (Çagatay, 2001). Unless income from the sale of these crops is pooled, and unless decision-making⁷ is consensual, it is possible that household food security and expenditures on health and education will decline, affecting in particular the well-being of women, children, the elderly, the disabled and the chronically sick (see Bolt and Bird, 2003, for a method for analysing intrahousehold differentiation).

This illustrates why it is important for trade policy analysts to understand likely patterns of household decision-making and how these lead to differential levels of access to and control of resources within the household (Ellis, 1993; Kabeer, 1994; Bolt and Bird, 2003). Without this understanding, increases in aggregate household income will be assumed to generate benefits for all household members and changes to introduce mitigating measures to dampen the negative impacts on women and children (in particular) of certain changes in trade regime will be missed.

2.1.3. Geographical location

People living in remote and low potential areas which are only weakly integrated into national and international markets are more likely to be poor than those living in capital cities (Bird and Shepherd, 2003b). Local markets may be thin and poorly functioning due to low levels of effective demand, under-investment in infrastructure, seasonally impassable roads and poor availability of agricultural and/or trade finance. Access to health and education facilities, to the cash economy and to a full range of goods and services is often hampered by poor access to affordable transport, weak infrastructure networks, poor service delivery, low levels of investment and low returns on investment (ibid).

Poor, or more costly, access to national and international markets by some regions will lead to muted price signals and so dampen supply responses. For such regions, the removal of price control and other forms of government intervention in markets will be less likely to result in an upsurge of private sector engagement than in near-urban rural areas. High transport and transaction costs, coupled with low local demand will often result in the slow development of markets. Low levels of competition between traders may result in low farm gate prices and little choice for producers, who may respond by partial disengagement from markets, prioritising production for own consumption and barter trade. The degree of engagement in markets will affect households' exposure to market-related shocks, so for households with few assets or savings to buffer them, disengagement can be an entirely rational response to risk. A study of the distributional and nutritional impact of devaluation in Rwanda during the 1990s found that changes in relative prices at the border had little effect on the predominately rural low-income households because of their isolation from the cash economy (Minot, 1998).

⁷ Sheila Page indicates, in her work on trade, climate change and poverty, that changes in trade may result in changes in the balance of power within the household (2001:19)

In order to take regional differences into account researchers wishing to analyse the likely distribution of costs and benefits from changes in trade will need to avoid presenting an aggregate picture for a whole country, and instead to assess how different areas, with different resource endowments and levels of integration into the national economy will fare.

3. How does the nature of poverty affect trade and trade policy?

The nature of poverty in a country affects the structure of trade that it is involved in (see Annex 1, Q5). While the focus of this paper is the impact of changes in trade on poverty, it is clear that understanding the nature of poverty in a country is important, due to the impact that it can have on both trade policy and policy outcomes. The structure and distribution of wealth in a country affects the structure of both demand and production.

High levels of poverty constrains not only effective demand and so the appearance of markets but also the availability of capital for investment. Due to high levels of idiosyncratic and covariant risk entrepreneurship (including innovation and investment) is reduced. In poor countries or in parts of a country where high numbers of poor people live, low levels of effective demand and high transactions costs result in weak incentives for traders. This results in weakly integrated markets and thin markets with few actors and low levels of competition. Where markets are poorly integrated the price and availability of goods can fluctuate considerably over time and space. Seasonal variability can affect consumers through changing the cost of a household's normal basket of goods, it can also damage producers as the vital inputs for manufacturing and other enterprises become either unavailable or unaffordable.

These problems create severe bottlenecks in the transmission of the benefits from trade. Opportunities which are apparent in urban areas or near borders, docks or trade depots are less apparent in remoter or poorer areas where concentrations of poor people are high. This dampens supply responses and can affect national levels of growth.

Levels of income and income distribution within a country will affect the volumes and types of exports and imports. A country with low average income, a small wealthy elite and a poor majority will have a profile of imports and exports which will include luxury and 'superior' goods for consumption by the elite, and mass consumption goods aimed at the poor majority. Countries with a high incidence of severe poverty are likely to have low levels of effective demand and thin and poorly functioning domestic markets. They are likely to import a narrow range of goods and services relative to population size, and have a limited number of low value or low skill-intensive exports reflecting the nature of the domestic labour force. A country with a larger middle class will have different consumption and production profiles again.

These are aggregate pictures. Numerous studies have been undertaken on the differential consumption preferences of different welfare groups and of women and men. The poor have been found to typically prioritise food purchases and health care expenditure. Other important items include low cost household goods and simple tools and farm equipment. An understanding of the consumption preferences of particular social groupings in a country will enable the design of complementary policies occurring alongside trade liberalisation to ensure that the poor benefit. This may be through phased protection of inferior food and household goods, in order to

protect groups identified as likely to experience declining well-being as a result of changes in trade regime.

Researchers into trade-poverty linkages should also explore the impacts on the structure of trade of a country having high geographical concentrations of poor people. It is also worth considering whether complementary policies and programmes might improve the transmission of benefits from trade throughout the population, reducing income gradients and increasing engagement in markets. For example, investments in improved infrastructure linking poor regions with transshipment points might stimulate enterprise and increase the availability and affordability of traded goods, increasing the engagement of poor populations in the consumption and production of traded goods.

An examination of how poverty affects trade will need to explore a number of complex relationships, for example:

- How will the spatial differences in levels of well-being and poverty in a country affect domestic and international trade in goods and services?
- How will concentrations of poverty by gender, socio-cultural group or livelihood activity affect the productivity of capital and labour, differential levels of surplus (and therefore the possibility of saving and investment and the sale of surplus for trade) and differential levels of household consumption and trade?
- How will investments in health and education and professional skill-creation benefit agricultural and industrial productivity, the generation of (high quality) surplus for trade and stimulate domestic demand for traded goods and services?

It will also be interesting to explore the impact of poverty policies on trade, for example the impact of social protection (e.g. pensions) or the extension of improved financial services to the poor in bolstering effective demand, investment and savings and so changing the nature and structure of trade.

4. Analysis of trade effects

When researching changes in trade policy it is important to consider *why* the policy change was made (see Annex 1, Q4). Did the government make the changes in order to meet domestic political objectives or international requirements? Is it anticipated that the changes will improve access to international markets and so stimulate domestic agriculture; increase availability and reduce price variability in food grains or increase levels of inward investment? The initial determinant of the policy change will affect stakeholders for that change, and may influence whether complementary policies are successfully designed and implemented or not. If policy makers are to design complementary policies which ensure that benefits are widely spread through the economy and population, and that costs are successfully mitigated against they need to be provided with information that predicts how a given policy change will affect all aspects of the economy and population. In order to provide this information, policy analysts need a rigorous understanding of the functioning of the economy (including sectoral linkages and bottlenecks), and an accurate analysis of the population. Policy makers also need to be provided with a comprehensive toolkit of social or economic policies which will plausibly smooth the implementation of changes in trade policy.

Analysis should include whether the short and long run impacts of trade policy changes on different sectors of the economy and different socio-economic or socio-cultural groups, has been adequately taken into consideration, and whether

complementary policies have been devised which will smooth the transmission of market signals and the distribution of benefits, or mitigate any negative effects.

As we highlighted above, changes to trade may result from macro-economic shifts and can be either beneficial or detrimental, with uneven distribution of the costs and benefits. Variation in exchange rates, for example, may outweigh the impact of trade policy changes, and an awareness of how such shifts in the macro-economy induce changes in trade is important. Policies to ensure that benefits are maximised and widely spread and that costs are mitigated against are also necessary.

In the section below we present some key trade policy instruments and the issues related to their reform.

4.1. Import/ Export Taxes and Tariffs.

A government may, unilaterally or as a result of bi-lateral or multi-lateral negotiations, reduce export or import tax. This can have significant impacts on trade and on the government's fiscal balance (see Annex 1, Q4.15 and Annex 2, Q1.12).

4.1.1. Impacts on trade

Reducing tax and tariff related barriers to trade can make imports more widely available and enable profitable export trade. However the distribution and intensity of first round impacts on poverty will depend on a number of issues, for example whether the poor are:

- working for wages in a sector which is now able to increase production and profitability due to improved access to international markets;
- net producers of crops which obtain a higher and more stable farm-gate price, due to their being freely traded on international markets;
- net consumers of a crop for which the government has removed export controls, leading to an increase in price (see Annex 2, Q1.2)

Most developing country producers are 'price takers' but, for those with a significant market share, such changes may influence the (domestic) price of exportables, international market price, or the price of the good in trading partner countries. In the longer run reducing barriers to trade may lead to a country following more closely its comparative advantage, leading to greater specialisation and increased efficiency - lowering prices, increasing competitiveness and perhaps market share (see Section 5.3 on specialisation). This may have an immediate effect on consumers and/ or industry and agriculture in that country.

Where the domestic price of a good has been artificially maintained at above international market price, poor net consumers will benefit. Net producers may lose out, but these are less likely to come from the poorest groups. Generally, consumers will also benefit from lower price variability. However, this may not be the case for products exported by few countries onto international markets, where producers form a price cartel or face similar climatic or other shocks. For example, Malawi's position as a food deficit country makes it politically vulnerable in its relationships with white maize trading partners South Africa, Zimbabwe and Mozambique. Its landlocked position makes it unable to bypass its neighbours in order to access international markets. As few countries export white maize, regional food insecurity in Southern Africa can lead to absolute shortages and substantial price rises.

Impacts will also depend on the structure of supply chains; the functioning of domestic regional markets and the sequencing and effectiveness of other economic and developmental programmes and strategies. So, the impact of the removal of import controls on maize, for example, may be predicted to have a net positive first round impact on the poor of a southern African country, where maize is a staple food. However, the simultaneous reduction in the holdings of the national strategic grain reserve, coupled with the removal of subsidies on maize meal from hammer mills and the suspension of pan-territorial pricing for purchases of maize by parastatal grain trading bodies would be likely to result in severe short run costs to the poor who, vulnerable to such shocks would be driven into food insecurity. However, the opening up of grain markets in southern Africa would be likely to have strong beneficial impacts on household food security and poverty if they are sequenced, and supported by investments in rural infrastructure and financial services, with mitigating social protection for the vulnerable (Bird et al., 2003).

4.1.2. Impacts on fiscal balance

Changes in trade-related tax can have a positive, negative or neutral effect on government revenue, depending on the reforms introduced and the particular circumstances of the country (Bannister and Thugge, 2001a). Changes in trade may reduce routes for taxation which have low resource mobilisation costs⁸ and high levels of political acceptability (e.g. export taxes on minerals, import taxes on 'luxury' goods), so the government will either need to identify alternative sources of revenue or cut spending. This is why domestic tax reform often has to be undertaken at the same time as changes in trade policy (McKay et al, 2000).

Reduced *import tariffs* will normally bring the price of imports and import substitutes down to nearer the international market price and reduce *total tariff revenues*, because in many poor countries tariffs generate a significant proportion of tax take. So, the lost revenue may have a significant impact on fiscal balance (Page, 2001, Bannister and Thugge, 2001a). However, changes in tariffs will not necessarily damage tax take, and the simultaneous reduction of tariff rates and the removal of tariff exceptions will actually increase revenue⁹. Where changes will result in a reduction, tariff revenue is conventionally replaced by value added or sales taxes. However, calculating the necessary rates and administering them can be difficult (Page, 2001). Also, progressive forms of taxation may damage vested interests, e.g. the formally employed urban middle class, resulting instead in the development of regressive tax regimes.

Identifying alternative sources of government revenue is particularly important where trade-associated tax-take is significant¹⁰. If a government fails to increase other, non-trade related taxes, its attempts to maintain macroeconomic stability will depend on reducing expenditure at just a time when income differentiation is likely to increase and greater demands are placed on government budgets (McKay et al, 2000; Page, 2001). Where cuts in expenditure are unavoidable, the country's political economy and donor strategies¹¹ will determine which sectors and population groups bear the losses, but the investment and developmental components of government budgets

⁸ Tariff revenue is administratively one of the easiest to collect (Page, 2001:18).

⁹ This is because items which had been exempted from tariffs will no longer be.

¹⁰ McKay et al, 2000 (in Page 2001:18) indicate that for 36 least developed countries trade-related taxes generate nearly one third of total tax revenue or around 5% of GDP.

¹¹ Donors may argue for particular policies, and use conditionality to lever government compliance. Historically this has included vetoing and/or refusing to support social protection measures (Andrew Shepherd, pers comm).

typically form a small portion of overall budgets. Recurrent costs are largely composed of salary expenditure, leaving governments with limited room for short-term adjustment.

The relative isolation of many groups of poor people and their low levels of successful engagement with policy processes and budgetary prioritisation may result in pro-poor public expenditures being vulnerable, relative to others. When regressive reductions in public expenditure take place it can negatively affect both quality of and access to essential services. Provision of such services is partially transferred to households with particularly negative effects for poor people. The non-poor are more able to absorb such increased costs than the poor, for whom public services perform a vital social protection function (Bannister and Thugge, 2001a). However, where such damage to the poor occurs as a result of either new taxes or reduced expenditure it is as the result of a political calculation. It is not the inevitable outcome, despite the constraints that developing country governments function under (Winters, no date). This is illustrated by an examination of the reactions of some East Asian countries which protected pro-poor expenditures in the face of far greater shocks, following the crisis of the late 1990s than any trade reform would produce (ibid).

4.2. Non-tariff barriers.

There are numerous non-tax related costs and barriers associated with trade, for instance those associated with regulatory or administrative controls. In Malawi, for example, maize exporters are required to obtain licences. These are only granted once the Ministry of Agriculture has determined that the country has produced a sufficient domestic surplus. Thresholds are set, and licences are granted up to this amount. Although licences are free, the process is centralised in Lilongwe and the bureaucracy and uncertainty is likely to dissuade potential traders (Bird et al., 2003).

The removal of non-tax barriers to trade will generate both first and second round costs and benefits, the distribution of which will depend on the sector affected and a number of country-specific factors.

Examples of the administrative and other barriers to trade include:

- Anti-dumping and other trade remedies
- Regulation of services and other trade related rules
- Safeguards
- Non-tariff barriers
- Export subsidies
- Other trade related institutions
 - Customs clearance
 - Export finance
 - Product standards
- Intellectual property

The table below summarises the potential impacts of these barriers to trade.

Table 2: The potential impact of administrative and other barriers to trade.

Form of barrier	Impact on trade	Potential impact on the poor (domestically & in trading partner countries)
Anti-dumping measures	<ul style="list-style-type: none"> Anti-dumping measures are likely to restrict trade. 	<ul style="list-style-type: none"> developed countries have been the main users (or abusers) of anti-dumping measures (“ordinary protection with great PR”), use of which has exploded since the late 1980s. A number of developing countries (e.g. India) have been significantly affected (by the attempted imposition of anti-dumping measures by trading partners). At the same time, developing countries have often suffered from dumping of subsidised European or North American agricultural products, undercutting developing world producers. Whether use of anti-dumping measures by a given developing country increases or decreases poverty obviously depends upon balance between net producers and net consumers of the good in question (notably in the case of staple foods) – but on balance seems likely to be anti-poor, or ineffective, more often than it is pro-poor
Regulation of services and other trade related rules	<ul style="list-style-type: none"> Liberalisation of Mode 4 of trade in services (i.e. of temporary migration) would likely lead to rapid expansion in “export” of these services by developing countries. GATS rules place limits on the use of government regulation of services as a barrier to the entry of non-national service providers: moving towards these principles is likely to open up trade in services (mainly from North to South, but potentially from MICs to poorer neighbours) 	<ul style="list-style-type: none"> Mode 4 liberalisation (e.g. through a “GATS visa”) would potentially result in significant increase in incomes which, repatriated or remitted, could contribute to poverty reduction. Against this must be balanced possible negative effects on service delivery or economic growth from (even temporary) out-migration of nurses or labourers. Also potential for developing countries to gain employment, incomes and access to technology and training through out-sourcing of backoffice functions or call centres: although benefits to the poor are admittedly indirect Fears that GATS rules constrain the ability of government to regulate services (and specifically to ensure access to services for the poor) are often overblown: more typically, increased competition from foreign providers helps lower prices to poor consumers. Capacity of government to design appropriate laws and regulatory institutions is critical to making the most of service liberalisation
Safeguards	Is likely to restrict trade in the short-run, until developing country producers can adopt new technology	Applying rigorous new standards may dampen economic growth in the short to medium term. May lead to consolidation away from small enterprise and artisanal producers and to larger companies more able to adopt new technology and invest in training. Negative impacts are likely to disproportionately affect the poor
Non-tariff barriers	Likely to reduce trade flows	Will, in general, have a negative impact on poor consumers, but the impact on poor producers depends on the product and its importance in their livelihood portfolio
Export subsidies	Likely to increase trade flows from the subsidising country. May undermine producers in	Food subsidies may benefit poor consumers but damage the livelihoods of poor producers. Subsidies of non-food commodities (e.g. cotton) are likely to damage developing country producers and up and downstream industries.

<p>Other trade related institutions</p> <ul style="list-style-type: none"> • Customs clearance • Export finance • Product standards 	<p>other countries.</p> <ul style="list-style-type: none"> • Customs clearance – red tape around customs is likely to damage trade • Export finance – is likely to enable export companies and to stimulate trade • Product standards – is likely to damage the trading opportunities of poorer less technically advanced enterprises, but increase trust/ consumer confidence in importing countries, stimulating trade 	<ul style="list-style-type: none"> • High levels of administration around customs clearance and product standards are likely to act as a barrier to entry to small firms run by poorer people, they might also tighten profit margins and may reduce firm's ability to expand employment – benefiting poor people, but increased consumer confidence may increase opportunities, particularly for larger firms with potential for employment growth • Export finance – is likely to have a positive impact on growth, whether this is pro-poor or not depends on the nature of the enterprise and its backwards and forwards linkages.
<p>Intellectual property</p>	<p>International agreements on intellectual property may increase trade. Slowing technical transfer to poor countries may mean that they must continue to import high tech and manufactured products.</p>	<p>International agreements on intellectual property extend copyright and patent protection, and place restrictions on low-cost technology transfer, penalising poor countries and poor producers.</p>

In this section we use product standards and intellectual property rights as examples of some of the important issues raised by these barriers to trade.

4.2.1. Phytosanitary Regulations

Phytosanitary regulations may be categorised as 'other trade-related institutions', under product standards.

The 1994 WTO agreement specified international standards on sanitary and phytosanitary standards for agricultural and fisheries products (Page, 2001:21). The regulations may lead a country to introduce higher standards than they would for the national market at this stage in its socio-economic and political development, and it appears that restrictive agricultural trade policies and agreements negatively affect food security (IFPRI, 2003).

The costs of any dampening of development caused by applying rigorous new standards will be met disproportionately by the poor (ibid) (e.g. when EU enforcement of regulations resulted in Ugandan, Kenyan and Tanzanian fresh water fish exports being blocked during the late 1990s, devastating lake-based fishing economies. The lack of access to export markets can, however, have differentiated impacts on men and women. Men gain income from selling fish to factories processing for the export market but women do not. They tend to be engaged in small-scale fish processing and see their incomes decline if there is a shortage of fish for them to process for local markets).

There is heated conflict currently between the USA and EU on food safety issues, which has become politicised. Much of this is due to differing policies on the genetic modification of foods. IFPRI suggests that such a conflict diverts attention away from the problem of food insecurity in the developing world (IFPRI, 2003).

4.2.2. Voluntary Certification Schemes

Organic and other forms of certification are another form of product standard, and are becoming increasingly important in terms of proportion of trade flows and market share, although still relatively small. There is a growing transnational movement concerned with global issues of poverty, environment and human rights. An example of a campaign that it has run concerns the issue of child labour in the carpet industry in India. This campaign has resulted in the creation of Rugmark, a label that certifies child-labour-free carpets and provides services for the rehabilitation and education of children involved in the carpet industry (Chowdhury and Beeman, 2001). Demand for organic, fair trade and other ethically produced and traded goods has increased significantly in European markets during the last decade - whether this is the child-free manufacture of carpets; the production of timber from managed forests; fish from sustainable fisheries with 'marine certification'; the 'fair' cultivation and purchase of coffee, or the production of meat products without growth hormones, or the cultivation and sale of organic cotton. Meeting the rigorous standards necessary for certification may increase costs and complexity of production, however, producers who become eligible for labelling under one of these schemes can sell at premium prices. Those able to meet 'ethical' or 'fair trade' requirements are likely to also benefit from longer-term contractual arrangements which provide certainty of reaching markets and reduce price risk several production seasons ahead.

However, demands for high production standards are not necessarily unambiguously beneficial. Importer countries making demands for high environmental and other production standards may use them as a form of protectionist non-tariff barrier. For example, trade unions in OECD countries have lobbied for international employment standards, supposedly in the spirit of comradeship, but actually in an attempt to protect the salaries and jobs of their own members. So, the integration of producer countries into international regulatory systems can damage poor producers in developing countries and effectively protect producers in richer countries (see Page, 1999).

4.2.3. Intellectual property.

Technological change or transfer of technology may affect production and/ or trade patterns and lead to the emergence or disappearance of new or existing suppliers of commodities. This, in turn, changes returns to different types of labour (e.g. those with specialist skills for working in a particular sector vs. semi-skilled generalists) and may influence incentives for acquiring education or for making other sorts of investment (Page, 2001:20).

International agreements on intellectual property (IP) have extended copyright and patent protection, placing restrictions on low-cost technology transfer (see Annex 2, Q2.1). This has generally penalised poor countries and poor producers, as while trade liberalisation tends to favour the abundant factor of production, the protection of intellectual property improves the returns to innovation¹², and protects returns to property, potentially giving developed countries oligopolist advantages while increasing the costs to those using the technology (Page, 2001:21). For low income countries, conforming to intellectual property regulation can place strains on the public sector and impose costs on the economy as a whole. This has been noted in recent debates with reference to the costs being faced by health sectors, particularly in SSA (e.g. through purchasing anti-retrovirals for the treatment of HIV/AIDS rather than manufacturing local generics) (Page, 2001). Some 'user countries' have argued that such measures could constitute a trade barrier (contrary to TRIPS) and there is currently renewed negotiation in this area.

With agreements on IP in place, technology transfers may still take place through foreign investment (see Section 5.2, below) or market purchase (Page, 2001:20).

4.3. Changes in international trade rules

Changes in the regulatory and tax burden and in opportunities or risks facing traders are not governed solely by domestic trade policies, they are also affected by international agreements and both the policy and *de facto* trading behaviour of trading partners and competitors. These changes may be unilateral, bilateral (including preferences), regional or multilateral, and they may involve any of the trade policy changes mentioned in the section above. Changes induced by economic growth, increases or declines in levels of poverty or other factors in trading-partner or competitor countries are dealt with elsewhere in this report (see Section 5, below).

¹² There has been limited analysis and registration of the intellectual property assets of the poor (e.g. indigenous knowledge registers, farmers' rights and benefit-sharing legislation) (Adrian Wells, pers comm).

Some of the key changes in the external trade policy environment are likely to include:

- a competitor or trade partner's obligations under the WTO; regional and bilateral trade agreements; consequential or autonomous changes in value of preferences under GSP schemes
- changes in international market conditions
- the impact of technological change affecting both the countries and third countries production and trading patterns

Researchers focusing on the trade-poverty linkages in a particular country may find it useful to use secondary data to compile an inventory of significant changes in the external trade environment. This can be used as the basis for a SWOT type analysis (strengths, weaknesses, opportunities, threats) which can be used to identify the factors in the external environment most likely to impact on trade in a way that will affect economic growth and poverty.

4.4. The impact of economic changes on trade

The macro-economic environment, both domestically and in trading partner and competitor countries, can have a significant impact on trade, through impacts on different segments of domestic and international consumer demand and through the transmission of changed production costs and risk signals to producers. Macro-economic shifts can also have a direct impact on both small and large traders, through, for example, access to and cost of investment and working capital and shifts in the relative value of currencies. So, factors in the domestic and the international macro-economy which can have a considerable influence on trade include:

- exchange rates;
- inflation;
- perception of risk to enterprise from government behaviour or civil conflict;
- impact of conflict (civil or regional) on patterns of investment, production and demand;
- consumer confidence and patterns of consumption;
- price smoothing through commodity and forex markets vs. the potential volatility of global markets;
- public expenditure and enterprise/ trade;
- regulation, taxation, subsidy;
- economic growth rates – growth in specific sectors (multipliers, linkages);
- growth and altered levels and structure of demand;
- variability of demand and
- domino effects.

We do not have the space here to trace through the impact that each element of the macro-economy has on trade. In this section we therefore focus on the impact that shifts in the exchange rate can have on trade.

The table below summarises the impact that key changes in the macro-economy – at the country and international level - can have on trade. The impact that these changes may then have on the poor is explored in Section 5, below.

5. How does trade affect the poor?

In this section we examine the impact that changes in trade policy, and real changes in trade regimes through the effective implementation of such policies, has or might be predicted to have on the poor. As part of this analysis we must examine the difference between *stated* trade policy and the policy *as implemented*. If there is a difference between stated policy goals and what is really happening, do these differences result in less good outcomes for the poor? The World Bank promotes the idea that liberalising markets results in poverty reduction. The Bank points out that poor countries, with combined populations of around 3 billion people, have broken into the global market for manufactures and services, and suggests that these “new globalisers” have experienced large-scale poverty reduction as a result (World Bank, 2002). However, linkages between trade and poverty are complex, making systematic empirical investigations difficult. Nevertheless, we attempt to trace the linkages through an examination of:

- economic growth and changes in production patterns, including an examination of impacts on overall prices; changes in the structure of firms and opportunities for labour mobility (Section 5.1);
- foreign direct investment (Section 5.2)
- increased specialisation (Section 5.3)
- changes in income and differentiation (Section 5.4)
- consumption patterns (Section 5.5)
- changes in well-being (Section 5.6)
- markets, including an examination of the extent to which poor have access to markets for the goods and services they buy and sell; the linkages between such local markets and international markets. We will also discuss the market related constraints faced by the poor, including their ability to influence markets (Section 5.7);
- the assets of the poor (Section 4.8)
- livelihoods and work opportunities (Section 4.9)
- coping with risk, shocks and vulnerability, including the shocks associated with trade reform (Section 4.10.)
- transfer income - remittances and both formal and informal social protection transfers (Section 5.11)

Trade liberalisation can lead to price and market effects which increase resources and offer new livelihood opportunities (e.g. through higher income or the construction or improved functioning of markets) or which result in decrease resources or threaten livelihoods through the reverse. Empirical studies suggest that trade reform has a positive aggregate effect on employment and income for the poor; however there are winners and losers (Bannister and Thugge, 2001b). Impact is mainly determined by the policies that are followed (or not followed) by the national government to redistribute income or assets through taxation, and through investments in infrastructure and other public goods, social protection and health and education (Page, 2001:19). If the short-run costs of trade liberalisation fall disproportionately on the poor, policies can be designed to mitigate these effects. These might include making reforms as broad based as possible, sequencing and phasing them to allow for adjustment, and implementing social safety nets and other reforms (Bannister and Thugge, 2001b).

However, suggesting that tax and investment policies will be adjusted to allow government to systematically compensate the losers from reform suggests that we expect governments to follow benign pro-poor and pro-development agendas. Analysis of the functioning of the neo-patrimonial state indicates that ruling elites may

not act with either poverty reduction or 'rational developmental objectives' in mind (Bird et al, 2003). The political economy of a country may result in a failure to recognise the needs and rights of particular poor and excluded groups. The distribution of costs to one group may be discounted because of the accrual of benefits to another.

5.1. Changes in trade and economic growth.

There is considerable debate amongst economists as to the linkages between trade, growth and poverty, even if we assume for the time being that increases in trade flows result unambiguously in growth¹³. This section highlights some of the arguments in this debate.

Since 1980 trade has increased substantially and tariffs have decreased (Dollar and Kraay, 2001). Increased trade flows can reduce aggregate poverty levels, largely through stimulating economic growth, but also through reduced consumer prices. Changes in trade can also have distributional impacts, as sectors expand or decline or elements in the value chain gain or lose. The poor can lose or benefit as a result of these changes. Dollar and Kraay have identified a group of developing countries with high levels of participation in international trade (e.g. India, China) which have seen economic growth rates accelerate through the 1970s, '80s and '90s while other countries in both the developing and developed world have seen growth rates decline. The 'globalisers' have begun to 'catch up' with the developed world while other developing countries have fallen further behind (ibid). Having analysed the distribution of income rate changes amongst different income groups in several 'globalising' developing countries, Dollar and Kraay (2001) conclude that there is little systematic evidence of a relationship between changes in trade volumes (or any other globalisation¹⁴ measure that they consider) and changes in the income share of the poorest. Increased globalisation led to increased economic growth, the growth is 'distribution neutral' – in other words, the poorest benefit as much as the rich – and so poverty reduction occurs but in absolute rather than relative terms.

Dollar and Kraay recognise that liberalisation creates short-run winners and losers, but argue that the losers do not come disproportionately from the poor (ibid). Ianchovichina et al (2001) do state that trade reform will have a positive effect on all income groups¹⁵. However, other researchers use empirical evidence to support their argument that the relationship between trade liberalisation and growth is not straightforward and that it depends on a number of external and country specific factors (Rodriguez and Rodrik, 1999a, in Kanji and Barrientos, 2002:10) including the existence of complementary and consistent macroeconomic and structural policies to foster adjustment and growth (Harrison and Hanson, 1999; and Rodriguez and Rodrik, 1999b). McKay et al (2000) agree that complementary interventions are important, as are a country's initial conditions and the way in which it implements trade reform. White and Anderson (2000, in Kanji and Barrientos, 2002:10) show that as far as the poor are concerned there may be a trade-off between growth and distribution, and that a focus on distribution might benefit them more (ibid).

¹³ McKay et al (2000) suggest that the basis for long-run growth is created by liberalisation leading to improvements in productivity, technology adoption and investment.

¹⁴ In this paper, globalisation is taken to mean the increasing movement of material, information and people across borders.

¹⁵ An assumption of homothetic preference results in larger welfare gains, while non-homothetic assumptions results in the poor gaining the most (Ianchovichina et al, 2001)

Reviewing the debate, Ravallion suggests that those taking a positive view of the linkages between trade, growth and poverty reduction support their argument with average figures instead of examining evidence of initial inequalities and how they change over time. By aggregating income changes, the differentiated outcomes of different groups is masked. Those with a more negative view highlight inequality, and show the negative impact on the poor of high or rising inequality (2000, in Kanji and Barrientos, 2002:11).

Where economic growth has effective linkages to poverty reduction (e.g. through effective distributory mechanisms, tightening markets for un- and semi-skilled wage labour and increased government and household investments in health and education) one might expect this economic growth to generate reductions in both the incidence and the severity of poverty. Though whether this occurs or not depends on the nature of the economy and its bottlenecks and transmission mechanisms (see Figure 1, below, for an illustration of direct and indirect effects, backward and forward linkages, multipliers and so on). Also, whether these improvements reach the chronically poor as well as the transitorily poor and extend into every sector, region and social group is a matter for local level analysis and policy design. Where they do not, it is up to the government to design appropriate redistributive mechanisms and to invest in public services and social protection. As we have mentioned above, whether they do or not depends on the political economy and the nature of democracy in the country.

5.2. Foreign Direct Investment

As we showed in Section 4, changes in trade regime may provide impetus for changes in the national economy and business environment. These changes may attract greater flows of investment, some of which might be FDI (foreign direct investment)¹⁶ (see Annex 2, Q2.2). However, not all countries are seen as attractive. Investors want to be able to predict high profits. A skilled and healthy workforce (completion of primary education is seen as a minimum requirement for unskilled labour) and good physical infrastructure are important determinants of investment location (Page, 2001:18). The policy environment is secondary (Sheila Page, pers comm), but investors prefer to see a positive relationship between business and government; high levels of transparency and predictability of action; low levels of rent-seeking, and low levels of macro-economic risk.

Where increases in FDI result in a net increase in levels of national investment there will be a direct increase in potential output and therefore aggregate national income. In countries with a shortage of investment capital, such new investments can have a particularly strong positive impact (Page, 2001:20). FDI can extend to investments in manufacturing, trade, distribution and services and a study of Bangladesh, Uganda, Morocco, Jamaica and Vietnam shows that TNCs are becoming increasingly important employers in many developing countries, particularly in certain parts of the service sector (Joekes, 1995). Investments can span sectors or realms of activity, for instance Nestlé's involvement in the Ivorian coffee sector, where they not only buy a portion of the coffee crop but process and export it (Andrew Shepherd, pers comm). FDI in trade and distribution can have a substantial impact through increasing producer access to agricultural extension advice and seasonal credit through market interlocking, and the development of outgrower schemes, and by increasing trader activity and competition through improved trader access to credit (Dorward et al,

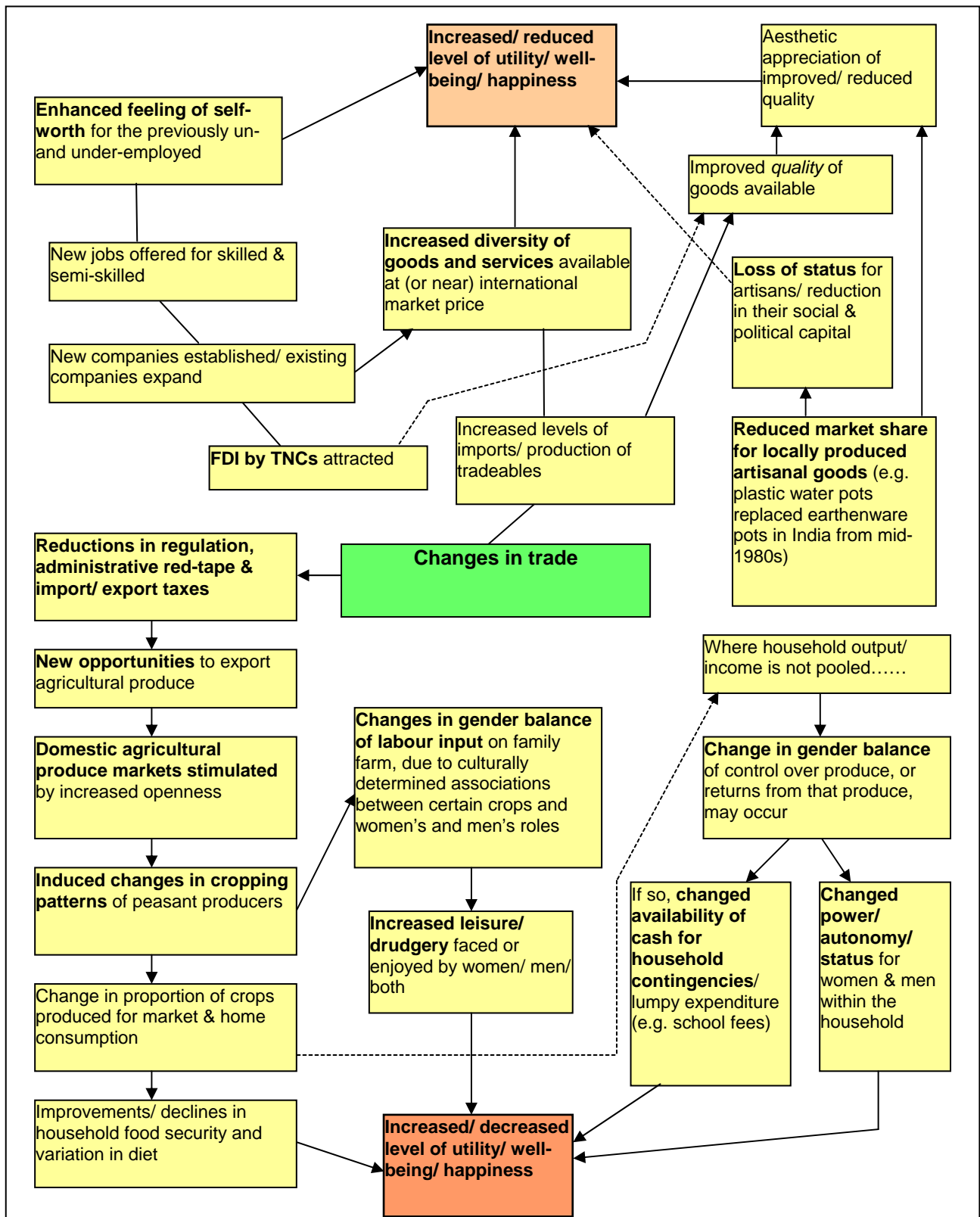
¹⁶ Foreign investment is often made with borrowed or part local capital, so 'foreign' is something of a misnomer (Page, 2001:20).

1998). Trade liberalisation in Ghana led to a number of international trading houses increasing their interest in the Ghanaian market, again with positive trade finance and new market benefits (Andrew Shepherd, pers comm). Cargill's involvement in the post-privatisation cotton market in Zimbabwe made prices for semi-arid small holder producers more regular, market access more certain and production more attractive to even quite poor households (Bird and Shepherd, 2003a). Also, FDI can help to stabilise demand, which is important to poor entrepreneurs and agricultural producers (Andrew Shepherd, pers comm).

Figure 1 shows that FDI can be linked to the development of new enterprises and the growth of existing ones, with positive knock on effects for employment. However, the net impact on employment within the sector will depend on the impact of such expansion on competitors. FDI is argued to lead to long-term improvements in efficiency and competitiveness, due to skills transfer raising local standards to international levels. If this is true, such capacity building in the national workforce can have positive multipliers. FDI is also one of the most efficient mechanisms for transmitting new technologies. This can have important multipliers, as workers with enhanced skills are more capable of establishing their own enterprise either in the same sector, or where skills are transferable, in another. This indigenising of entrepreneurialism can have considerable benefits on the economy as a whole. Where enterprises draw in semi-skilled staff, the distribution of first round benefits is likely to be more pro-poor (see Figure 1, below – which can support the tracing of the possible impacts of any of the changes associated with modifications to trade regimes).

The net impact of attracting FDI (or the location of TNC operations) to an economy will depend on how strongly the new enterprise or expanded sector is linked in with the rest of the economy through backwards and forward linkages and on the nature of its workforce. Where foreign investment is geared towards production for local markets a portion of the benefit from increased production will accrue in the form of profits to investors and the balance to the local labour force and through up and downstream linkages to suppliers and other manufacturers. The more integrated production is with the rest of the economy, the bigger the local share (Page, 2001:19). Impact will also depend on the robustness of local competition. It may be that the short-term impact of such investments results in declining market share or profitability for local firms. However, the medium- to long-term impacts of such investment may be positive. The ultimate outcome will depend on the nature of the investment and on local variables, including the skills and adaptability of local labour and entrepreneurship and it is impossible to know *a priori* what share will go to local labour and local entrepreneurs (ibid).

Figure 1: Examples of changes in trade's possible influence on the intangible components of well-being.



5.3. Increased specialisation

An empirical question that needs to be asked at the country level is whether increases or decreases in liberalisation affect the degree of specialisation in the economy (see Annex 1, Q6 and Annex 2, Q1.3)). Theory suggests that as trade distortions are removed (e.g. tariffs, quotas, subsidies), inward and outward trade is likely to increase, resulting in long-run increases in national level specialisation along lines of comparative advantage. This is rarely in a predominant export, as most dominant exports already have good (or even preferred) access into markets (Sheila Page, pers comm). However, such shifts might be expected to result in more efficient resource allocation and production within the economy as the economy focuses on areas in which the country has comparative advantage¹⁷ and production shifts to the cheapest location (Page, 1999), resulting in enhanced economic growth¹⁸ (Kanji and Barrientos, 2002:17).

The liberalisation of international, regional or bilateral trading arrangements can be highly negative for countries with highly specialised economies dependent on one or a few exports. They are exposed to considerable risk of changes in the price of that good or in the supply conditions for inputs. So, although the specialisation of an economy in line with comparative and competitive advantage is theoretically advantageous, there are risks attached. Diversification (as opposed to specialisation) has been shown to be the rational response of poor agricultural producers to high levels of risk and vulnerability (Ellis, 2000, Scoones, 1996) and most governments want to see a reasonably broad based economy. As a result they have strong policies directed to diversification, for example the promotion of non-traditional exports¹⁹. Incentives generated by their policies, or resulting from their investments in education or in regional development²⁰, and by the enabling or disabling environment created by regional or international treaties may generate countervailing signals, dampening the impulse to specialise. So, research must explore what actually happens.

If specialisation occurs, the direct and indirect effect that it has on poverty will depend on the characteristics of the sector that specialisation is occurring in, the ability of producers and entrepreneurs to adapt rapidly to new incentives (Kanji and Barrientos, 2002:15), and whether specialisation at the national level results in regional and household level specialisation. If the expanding sector produces goods which are used in-country or is low-skill labour intensive, the poor may benefit through the increased availability of the product at lower prices, through being employed, or by increased demands for low-skill labour leading to a tightening of the

¹⁷ Kanji and Barrientos (2002:15) suggest that much of the liberalisation of trade during the 1990s was based on the logic that the dismantling of protectionism (tariff barriers, quotas) will allow countries to follow comparative advantage, increase access to domestic and international markets, increase producer prices and remove the urban bias generated by controlled prices. Freer trade is also expected to increase global demand for developing country exports, often produced with large inputs of unskilled labour, increasing employment, raising wages and reducing income poverty.

¹⁸ However, the view that trade liberalisation promotes growth, which leads to poverty reduction is largely based on assessments of aggregate income and consumption measures of poverty (Kanji and Barrientos, 2002:6).

¹⁹ The effectiveness of such policies varies, with Côte d'Ivoire successfully diversifying during the 1990s but neighbouring Ghana seeing little change (Andrew Shepherd, pers comm).

²⁰ The benefits/ loses arising from specialisation are in part dependant on physical infrastructure, distance, levels of accessibility/ isolation to markets and inputs, transport costs and other real barriers to trade.

labour market and increased wages (see Annex 2, Q4.1). If the product is mainly for export or is highly resource or capital intensive, the direct effects will be on profits or rents, and poverty reduction will depend on second round policies. If the sector is geographically concentrated (e.g. the Zambian copper belt), the costs and benefits may be regionally concentrated. Households in the specialised area may narrow their livelihood portfolio, allowing them to maximise the benefits they gain from the sector while it is in its ascendancy, but increasing their vulnerability to shocks. If this strategy of household specialisation is widespread covariant risk will increase, exposing whole communities to shocks. Following a shock, traditional safety nets may be unable to cope, and a whole region may slip into poverty.

A review of experience around the world indicates that specialisation in simple manufactures or small-producer agriculture has more immediately favourable effects on the poor than specialisation in mineral exports. However, mineral exploitation can be attractive to governments as it provides them with a politically acceptable tax base. Governments with a developmental or pro-poor focus can then prioritise redistribution, and so benefit the most vulnerable citizens.

5.4. Changes in income and differentiation

In the section above we showed that increased trade flows can result in economic growth. The World Bank also regards global integration (globalisation) to be a powerful force for poverty reduction (World Bank 2002). However, there is a range of views as to the truth of this. McKay et al (2000) suggest that although trade liberalisation *cannot* be considered to be a poverty reduction strategy in its own right, it can have substantial indirect effects (positive and negative, short-term and long-term) on poverty.

If trade does result in economic growth, an issue is whether that growth is evenly distributed or not. Where differentiation is increased, due to the uneven distribution of costs and benefits, it is important to identify the determinants of a particular distribution. If those systematically losing out as a result of policy change are those in remote rural areas, urban slums, the chronically poor or excluded or minority social or ethno-linguistic group then we need to be aware that the domestic political economy of a country is not likely to result in compensatory policies to mitigate any negative effect.

Reforms may increase overall poverty at the same time that they are increasing incomes in total (McCulloch et al, 2001). Studies from around the world provide considerable evidence that liberalisation can cause greater differentiation in both income and assets between and within countries (Kanji and Menon-Sen, 2001). Yang and Huang (1997) show that in China economic growth over the last few years has resulted in poverty reduction, but also in increased income differentiation, and in Latin America unskilled labour lost more than other workers as a result of trade reform (McKay et al, 2000). In fact most trade reform affects income distributions, pushing some into (or deeper into) poverty, while benefiting others. Harisson et al (2000) suggests that trade liberalisation *does* result in some groups of the rural and urban poor being worse off – in the absence of compensatory transfers. Devarajan and Mensbrugge (2000) show that in the South African context impact of removing tariffs will be differentiated by ethnicity. Average welfare for white households will be reduced, but the average welfare of black households will be improved. *Within* ethnic groups, richer black and poorer white households are likely to benefit.

A study of the impacts of trade reform on the poor in Morocco, using rural-urban GE analysis, suggests that trade liberalisation in agriculture will result in gains for the country as a whole, but that the poor will lose out. Mitigating measures to compensate the rural poor will be necessary if the reform is to be pursued without causing hardship (Lögfren, 1999). Another study, focusing on Indonesia, found that few or no households were made *worse off* by increased openness to trade, but that gains from liberalisation were skewed towards the urban rather than rural populations and the wealthy rather than the poor, increasing differentiation (Friedman, 2000).

In order to trace the impact of changes in trade through to the local level we might wish to examine the transmission of effects to local markets and so through to local livelihoods. These issues are examined in the Checklist (Annex 1) and Matrix (Annex 2).

5.5. Consumption patterns

One of the prime ways in which trade liberalisation affects the poor is through the change of prices of liberalised goods, their substitutes and goods for which they form substantial inputs (McCulloch et al, 2001)

Decreased barriers to trade can result in changes in the aggregate levels of trade and the composition of trade. There may be increased levels of imports across one or a number of sectors and decreased prices of imported and local (substitution) goods. This affects the choices that consumers can make regarding goods and services and may result in moving some households above or below the income poverty line. In general consumers benefit from trade reform and this includes the poor (McKay et al, 2000). The distribution of costs and benefits from these changes will depend on who produces the local (substitution) goods; whether the sector is labour intensive, attracting an unskilled or semi-skilled poor workforce; whether there is a gender, ethnic or other social dimension to the workforce, and whether the good is produced in household based micro-enterprises or is mass-produced. Another important factor is who currently captures the 'rents' derived from barriers to trade, as this will influence which group will be most affected by a reduction in market share and/ or profitability of the good.

Whether the opening to imports will have short or long-term implications for the individuals and households affected will depend, in part, on which group within the population makes up the majority of consumers for the (now cheaper and more widely available) import or substitute good. If they are the poor, it is possible that despite possible increases in unemployment and declines in wages there will be a net benefit to the poor as a whole. However, it may be that the costs accrue to one group of poor people and the benefits to another, or that the costs for one group outweigh the benefits they receive. In such cases policies to mitigate short term declines in income and well-being may well be needed. If the typical consumers of the good are non-poor²¹, and the labour force involved in the manufacture of the now uncompetitive and declining domestic industry are poor, then the short-run impact of the change is likely to be regressive.

There is also a whole realm of less obvious impacts which are generated by altering the incentives faced by individuals, households, communities, enterprises and sectors. For instance, the enterprise mix of a peasant farmer may shift because she

²¹ The key consumer group may not be even throughout the country (perhaps due to religious or cultural preferences), leading to a regionally differentiated impact.

is now able to access imported fertiliser at an affordable price. She may increase the acreage of maize, decrease the acreage of pearl millet and groundnuts and benefit not only from greater income but increased leisure (cultivation and post-harvest processing of millets is highly labour intensive, processing groundnuts – for those without access to mills – is also slow and laborious). However, her exposure to rain-failure risk will increase and unless the markets start functioning better than they do at present (e.g. in rural Uganda and semi-arid Zimbabwe), she might find buying protein to replace the groundnuts difficult and so household food security may be compromised. The decision to reduce millet production is likely to have been replicated by other women farmers in the region and though beneficial in terms of reduced drudgery, will have reduced access to millet for beer brewing, an important source of female-controlled cash income for contingencies and ‘lumpy’ expenditures (e.g. school or medical fees), and an important input into communal events and payment for communal labour (Bird and Shepherd, 2003b).

5.6. Changes in well-being

Changes in trade can also affect the more intangible side of an individual's, household's or community's well-being (see Annex 1, Q7.9).

Changes in levels of social and political capital may result indirectly from changes in trade. The mechanisms by which changes in trading environment can generate alterations in the involvement of groups and individuals in social networks; in their perceived level of social or cultural isolation and/or their inclusion or exclusion from mainstream or sub-cultural society; their political voice and access to decision-making are explored in greater depth in below.

The distribution of positive and negative changes in social and political capital and levels of inclusion or exclusion as a result of changes in trading environment will be differentiated. Social identity, location and livelihood grouping or occupation (etc.) may help to determine the distribution of these changes.

5.7. Changes in trade and market access.

Changes in domestic trade regime, the domestic macro-economy, the trade regimes of trade partners of competitors and global economic factors can all affect the opportunities and risks for traders. Transmission mechanisms route these changes through the economy as a whole, but how changes in any one aspect of the domestic or international trade context will affect traders themselves, actual trade flows and how markets function will depend on local contextual issues.

5.8. The impact of trade on household and community assets.

In this section we present approaches for examining the likely impact of changes in trade regime (and associated policies) on community and household assets (see Annex 1, Q7 and Annex 2, Q1.1b, Q1.4). Building an approach based on DFID's sustainable livelihood framework (see Carney, 1998) may help researchers to systematically include rather more intangible (social capital, political capital) as well as tangible types of asset (natural capital, physical capital, financial capital and human capital). Contextualising change by use of the livelihoods framework should ensure that the role of institutions and governance processes and the vulnerability

context of the poor (vulnerability, shocks, trends and seasonality) are given proper attention (see Annex 2, Q1.5). Use of the framework should ensure that these changes are thought through in terms of their implications for individual livelihood activities, household livelihood portfolios and well-being. However, it can be difficult to combine this kind of grass-roots analysis with macro-level policy analysis. This is something that we attempt to overcome in this paper (for methods combining macro and micro analysis see Annex3 on *Appropriate research and data analysis methods* and Ashley et al, 2002a,b and c).

5.8.1 Trade and the human capital of poor people

In this section we examine the impact that changes in trade may have on the human capital of the poor (see Annex 1, Q7.3). People's human capital or capabilities are affected by their health and skills or level of education. Health is obviously affected by genetic factors, food security and nutrition, environmental factors and exposure to infection.

Trade liberalisation may affect levels of human capital directly, through altering the costs and nature of inputs for health care and education (e.g. through insurance markets, in the long term). However, many of the impacts are likely to be indirect through changes in the amount of money available (within the household) to finance expenditures on education and health and to maintain food security, due to:

- changes in the (pooled) aggregate household income available for contingencies and lumpy expenditures
- changes in the amount of cash-income and/or easily liquifiable assets held by whoever is responsible for expenditures on health and education (e.g. through access to new and more highly paid employment or through changes to the cropping patterns and the livelihood portfolio of the household).

Where household income is pooled and household decision-making is joint or consensual, an aggregate increase in household income can be presumed to be an accurate proxy for an increase in well-being for all household members (*ceterus paribus*). However, as we show in Section 2.1.2 above, norms regarding the pooling of income and the making of household decisions differ and separation within the household is frequently maintained in terms of income and responsibilities. This makes the outcomes of changes in trade less predictable. So, changes to trade which provide new employment opportunities or increased wages may:

- increase disposable income, making it possible to enrol children in school or keep them in school for longer; to pay for more/ better/ earlier health care interventions; to afford a more varied and nutritious diet; to improve living conditions and therefore both mental and physical health and well-being
- increase the disposable income of one individual, but not improve the level of consumption or well-being of the household as a whole
- increase disposable income, but reduce the time available for leisure and reproductive tasks. This 'time-squeeze' may lead to 'self-exploitation' (Ellis, 1993) and declines in both tangible health measures and intangible well-being, or to the withdrawal of children from school to take over some reproductive tasks (Page, 2001:19)
- increase the disposable income available to support food security and investments in health and education, improving both immediate and long-term well-being for the household

Changes in trade may also lead to short-run declines in employment or increase risks or reduce returns to the livelihoods of the poor. It is important to that these are distinguished from normal fluctuations and also from changes resulting from other policies or household-level events. We explore causality in Annex 4: *Appropriate research and data analysis methods*.

A shock or series of shocks is likely to induce coping. As we show below in Section 5.9, *Coping with risks, shocks and vulnerability*, households will sequence the way that they draw down on their assets in order to preserve those that they value highly. The poor depend heavily on their own labour in order to develop a livelihood. They may view education as a long-term investment (school fees and equipment, opportunity cost of time) which will raise the returns to (their children's) labour. If this is the case, it is not inevitable that reductions in either aggregate household income or in the disposable income (and liquifiable assets) of those responsible for maintaining household food security and human capital investments will result in children being withdrawn from school. However, sharp declines may eventually mean that children must find work paid in cash or kind (possibly coupled with their withdrawal from school), or take on reproductive tasks, to enable their mother or older siblings to engage more fully in productive tasks or paid employment.

Changes in trade regime can have important direct consequences for the working poor through increasing returns to educated or healthy labour. This may be because a more open economy has attracted foreign investments (see Section 5.2, *Foreign Direct Investment*), new jobs are available and the labour market has tightened, driving up wages, or it may be that reduced trade barriers has led to increased levels of export, increasing the profits accruing to a sector and the surplus that micro-entrepreneurs can extract for household consumption. Although increases are possible, decreases are also possible, and the movement of change and distribution of such changes will depend on local conditions. Indirect impacts on returns to labour (both positive and negative) can also occur through changes in levels of taxation and government expenditure.

Where returns to educated labour increase, and to skilled labour in particular, this can have a set of beneficial impacts – other than the immediate impact on increased disposable income. The value that poor households place on education may increase, as they see tangible evidence of returns on the investment improve (see Page, 2001:19). There might be a gender dimension to this, if there are gender-based rigidities in the labour market, and as we have shown increasing returns to labour may, in fact, result in children being withdrawn from school to replace adult household labour.

The distribution of benefits from increased returns to labour will depend on whether

- the increase is confined to a small, geographically confined and poorly connected sector, or a large sector with high levels of employment and strong up- and downstream linkages into the national economy
- whether the labour market within the country functions efficiently, or whether recruitment is strongly influenced ethno-linguistic identity, gender, nepotism and rent seeking. Inefficient labour markets may fail to transmit improved returns in one location, in one sector, to other parts of the country and other sectors.

Increased returns to skilled and healthy labour may be highly beneficial to those individuals, their families and the broader economy. However, the benefits of such improvements may accrue largely to the non-poor and to the well-connected urban and peri-urban parts of the country. The chronically poor are likely be largely excluded from such opportunities because of their inferior education and skills and

their poorer health. Older people, the chronically ill and child-headed households - often the poorest in any society – will not benefit directly from such improvements in the economy, although they may do through intra- or inter-household transfers of formal social protection (see Section 5.11). Without such transfers, one might anticipate widening differentiation within society. The political economy of a country will determine the level of differentiation that is acceptable, and the likelihood of implementing mitigating measures through taxation and social protection.

5.8.1.1. Child labour.

As pressure increases on governments to implement policies connected with international agreements on the rights of the child more attention has been centred on the widespread use of child labour. Lobby groups have focused on child workers in export industries, however the employment of child workers in export industries, such as textile, clothing, carpets and footwear are relatively limited in comparison with those employed in activities geared towards domestic consumption (ILO, 1996 in Page 2001:19). Probably less than 5% of child labourers are employed in the export or mining sectors, and only 1 to 2% in export oriented agriculture.²²

Sheila Page suggests that limiting trade with countries that use child labour may reduce these country's economic growth opportunities and ultimately aggravate both poverty and levels of child engagement in the labour market (Page, 2001:19). Perhaps the most effect way of reducing children's involvement in onerous employment is to find ways to stimulate pro-poor economic growth which will generate higher return employment opportunities for poor adults, reducing their household's dependence on children's wages.

5.8.1.2. Impact of increased labour mobility.

GATS is likely to increase international labour mobility, increasing both opportunities and competition for poor workers (see Annex 1, Q8 and Annex 2, Q1.11). Increased migration, particularly of less skilled workers, has huge potential for poverty reduction (McCulloch et al, 2001). Migration raises the income of those who migrate (who are not generally the poorest) and their remittances can raise the immediate incomes of the poor and provide capital for investment. However, 'sending areas' that are net losers in terms of 'skill/ labour' drains can be damaged, and it is necessary to assess whether remittances are adequate 'compensation' for this. There can also be heated political resistance to migration in 'receiving areas' as local labour is displaced and cultures clash. McCulloch et al (2001) suggest that in order to maximise benefit from increased labour mobility, resolving any political and practical difficulties should be prioritised.

5.8.1.3. Food security.

As we have shown elsewhere in this paper (see Section 2.1.2) changes in total household income, or in the income of certain members of the family, can lead to

²² This may be an under-estimate of the true number of children employed in export-related agriculture. Many child agricultural workers are informally employed in working part or full-time in household agriculture, and therefore have low levels of visibility. The surpluses from (peasant) household agriculture may be sold onto local markets, and eventually find themselves traded internationally.

either improvements or declines in nutrition, diet variation and food security (see Annex 2, Q1.6). We have also shown that changes in cropping pattern can lead to a similar range of results.

Important positive or negative changes in household food security can occur as a result of modifications in trade regime due to:

- shifts in relative prices in the economy (e.g. terms of trade for agricultural vs. manufactured goods), making the income/ production-in-kind of the poor either go further or less far.
 - If relative prices of food increase, net consumers (i.e. those purchasing more from food markets than they sell) may find it difficult to maintain food security.
 - If changes create incentives to increase production of non-food commercial crops and decrease production of food crops, household food security of producers may suffer if local markets or household decision-making processes mean that the shortfall in household food is not compensated for
 - if it generates incentives to change the balance of food crops produced (e.g. to monocrop rice, rather than grow rice and pulses) resulting in reduced local access to a wide range of staple crops, vegetables and pulses
- real reductions/ increases in the local market price for food staples or in 'inferior' (often non-traded) non-food items which make up a significant portion of the 'consumption basket' of the poor
- real reductions/ increases in the local market price for inputs for the productive enterprises of the poor (e.g. agriculture: fertilisers, hybrid seeds, pesticides, labour; bicycle repair: oil, spare parts, labour)
- changes in levels of competitiveness of domestic industries leading to job losses or increased recruitment

Changes in food security can be monitored through measures of child stunting and wasting and through physical evidence of macro- and micro-nutrient shortages. Poor nutrition can be a sensitive indicator that the poor are failing to cope, and can be useful trigger for public sector social protection measures.

5.8.2. Trade and the social capital of poor people

Social capital is made up of the kinship, friendship, religious, community-based, professional and other networks to which people belong²³ (see Annex 1, Q7.4). Being socially excluded is regarded as a powerful indicator of relative poverty and individuals and households with low levels of social capital are likely to have limited access to informal safety nets and certain livelihood activities. Social capital can be an important enabler, and can be a significant component of an individual's cultural identity, however, it can also represent regressive forces (e.g. criminal gangs; anti-integration ethnic movements - neo-fascist youth may club together to victimise a migrant worker; village elders may fine a low caste individual for breaking local taboos).

In much of the development literature social capital is assumed to have purely positive attributes, however, we would encourage researchers to be aware of social capital's potential for negative impacts.

Robust social capital networks, which function vertically as well as horizontally, are an important precondition for redistributive traditional safety nets. Without such networks, poor households must attempt to cope with adversity alone. However,

²³ Some understandings of social capital include access to information (e.g. news).

establishing and maintaining such networks may involve humiliating or asymmetric relationship (e.g. a poor man 'befriending' a wealthy man by giving him regular gifts).

Community cohesion may be damaged as a result of changes in trade if:

- shocks to livelihoods result in the widespread adoption of coping mechanisms which draw down on social capital to generate flows of transfers (traditional safety nets) or destroy social capital through begging from neighbours, theft or prostitution etc.
- opportunities are created for some but not others, resulting in increased income differentiation
- traditional livelihood activities are destroyed. This can damage social capital, where the activity was an important focus around which other activities were organised

Entry into trade-related livelihoods may be affected by social capital. For example, households in semi-arid communal Zimbabwe with urban-based kin were able to trade peanut butter and other processed goods in the cities. Without an urban linkage they had to try to sell their surplus products locally and less profitably (Bird and Shepherd, 2003a). Similarly, individuals wishing to become involved in international trading may find it easier to do so if they have good networks in business and government circles. Their contacts may explain complex regulations, facilitate access to credit, provide them with introductions to trading partners and draw them into cartels. People without membership of these networks may experience very high barriers to involvement in trade-related enterprise. Ethnicity, gender, religion and other forms of social identity may be strongly associated with membership or exclusion from networks, resulting in trade having a particular social structure. This may result in a dominant group (based on ethnicity, gender, location etc.) being able (perhaps through monopoly or oligopoly power) to control prices or extract rents. It may also be able to prevent border price increases or reductions from being transmitted down the production chain to the poor. An issue for research at the country level is to assess whether this is the case, and to examine whether changes in trade policy and associated changes will affect the social structure of trade and therefore the transmission and distribution of costs and benefits.

5.8.3. Trade and the physical capital of poor people

The physical capital of poor households is usually limited to their house, household utensils, farm implements or other artisan tools and perhaps a bicycle or radio (see Annex 1, Q7.6). Changes to trade may affect these assets if shocks result in coping strategies which require their sale, or if improvements allow accumulation to occur. Monitoring changes in asset levels can be important in smoothing out short-term fluctuations in income and can indicate important patterns of negative coping and impoverishment or positive accumulation and poverty reduction.

5.8.4 Trade and the natural capital of poor people

Changes in policy and regulation may increase or decrease the profitability of particular enterprises. In turn, this may affect the way that enterprises use natural resources as inputs and discharge wastes into the environment resulting in altered levels of environmental damage (see Annex 1, Q7.7). This damage can be to private goods (e.g. privately owned land); common property resources (e.g. grazing land, water resources) or public goods (e.g. air quality), as the actions of individuals or groups may create positive or negative externalities which affect others.

The type of environmental impact that follows from changes in trade will depend on the particular policy change, its transmission through the economy, and any local, national or international environmental regulations. The impact of trade liberalisation on the environment can be difficult to predict. It tends to magnify cases of good and bad natural resource governance, with implications for poverty reduction (Adrian Wells, pers comm.). For example, reducing barriers to cheap imported timber will reduce the profitability of lower quality timber for the domestic market. Where social capital is limited and transactions costs high, this exacerbates illegal logging, especially in remote areas with weak law enforcement. But where social capital and market access is sufficient, trade liberalisation increases opportunities to tap into high-end markets e.g. for certified timber (Adrian Wells, pers comm.).

Another example is where reduced import taxes for nitrogenous fertiliser increases its availability and affordability and encourage its more widespread application. This may result in increased outputs improving local food availability, increasing profits for some farmers, and greater demand for casual labour, resulting in quite significant poverty reduction. However, misapplication of the fertiliser could, for example, result in the pollution of both groundwater and streams, poisoning household water supplies and damaging local fish stocks, causing long term harm to the livelihoods of migrant fisherfolk. Conversely, the removal of import taxes on nitrogenous fertiliser could result in the collapse of an uncompetitive domestic manufacturer. Local availability of fertiliser could become more variable resulting 'fertility mining' as farmers continue to attempt to produce the same yields while reducing fertiliser applications.

These different possible outcomes illustrates the importance of understanding local conditions, and developing high quality sectoral understandings.

5.8.5 Trade and the financial capital of poor people

The financial capital of poor individuals is affected by their ability to generate cash income, their ability to save in cash or in easily liquefiable forms, their ability to access credit and their access to insurance mechanisms (see Annex 2, Q3.5). Changes in trade may affect the financial capital of individuals and households most directly through increasing or reducing their income or by increasing or decreasing the cost of household consumption (see Annex 1, Q7.8). In the sections above we have traced through how this might occur by directly affecting the profitability of enterprises or by altering terms of trade or the cost of a normal basket of goods. We have also discussed how trade may affect income and income distribution through stimulating economic growth.

These impacts may be compounded by the effect of complementary policies implemented simultaneously to trade reform. These can include taxation and public expenditure policies and other macro-economic reforms. For example, trade liberalisation often occurs alongside reforms to the financial sector. Where banks are privatised, the removal of the state can be beneficial to the independence and robustness of the sector as a whole. Increased competition can help improve the availability and quality of financial services in urban areas. However, reform has resulted in the rationalisation of many rural banking networks in Sub-Saharan African countries where transactions costs are high and the effective demand for banking services are low. Much of the rural branch network has been closed, making access to financial services more difficult for the rural poor. Where financial services markets are poorly developed or in decline, access to investment finance or working capital

can be difficult. This limits the launch and expansion of new trade-related enterprises, limiting both opportunities and competition. This can affect the distribution of benefits from an increasingly liberalised trade regime.

Another cause of reduced money supply in rural areas is that trade-related shocks can result in the further withdrawal of peasant producers from markets, shrinking the local cash economy, and reducing the cash available for investment and consumption.

The poor often access credit, particularly seasonal credit for agriculture, through interlocked market relationships with traders and processors. Where changes in trade result in changes in financial markets these traders and processors may find it more difficult to access credit themselves. These constraints may be passed down the line, and the poor may be constrained in producing marketed surplus, leading to increased poverty and asset erosion.

5.8.6. Livelihoods and employment.

As we have shown in the section above, trade and changes in trade, can have a significant impact on the assets of individuals, households and communities. People use their capabilities to make the most of their assets and develop livelihood and coping strategies to maximise (or optimise) income and well-being (see Annex 2, Q1.1b). There is a trend across SSA for rural households to increasingly diversify their livelihoods and sources of income (Ellis, 2000). This is a risk spreading response to lower and variable per capita agricultural sector returns, but it dampens innovation reducing further the growth potential of the whole economy (Kanji and Barrientos, 2002:15).

Responses to risk are also partly to blame for the weak supply response in SSA. Aggregate exports from all SSA countries are growing at less than half the rate of other developing countries and its share of total world exports declining. Critics of liberalisation argue that this is partly because liberal trade damages peasant producers, as they are not well-placed to react to either new threats or new opportunities (Kanji and Barrientos, 2002:16). Their limited access to land, technologies and market information makes it difficult to meet quality specifications. Poor infrastructure, high transport costs, limited access to financial services and high and variable input costs makes it difficult for them to compete (*ibid*) and socio-cultural norms (e.g. around gender-based roles, attitudes to the successful, fears of witchcraft etc.) can act as a further disincentive. This muted supply response is unlikely to be reversed without sequenced investments to redress high risk and vulnerability, low productivity and low assets.

Whether this negative picture is true or not depends on local conditions prior to and following liberalisation as illustrated with two examples from Zimbabwe. Prior to liberalisation in Zimbabwe the government was a monopsony buyer of cotton from farmers. It kept farm-gate prices low in order to supply cotton at below international market price to the textile industry. Larger commercial farmers responded to the poor prices by diversifying into other crops such as horticulture and tobacco, but smaller and poor farmers found such diversification difficult and suffered. The elimination of price controls and privatisation of the cotton marketing board resulted in higher farm-gate prices and greater competition amongst the three principal buyers who competed on price and through the supply of extension advice and other input services to small farmers. As a result poorer farmers benefited from increased market opportunities, higher prices, and the improved availability of extension and

input services. Such changes across the agricultural sector led to a substantial rise in agricultural employment (of 40% from 1988 to 1997) and increased production of both traditional and non-traditional (horticultural) agricultural products (Winters, 2000). However, peasant producers are heterogeneous and only a minority of peasant producers in Zimbabwe's semi-arid communal lands produce cotton. Only the less poor can afford purchased inputs, so although these reforms benefited relatively poor producers, benefits did not extend to the poorest (Bird and Shepherd, 2003). Smaller, poorer maize producers, especially those further from markets have been negatively affected by the rationalisation of the GMB's (Grain Marketing Board's) network of grain depots. They responded by retreating further into subsistence and barter-based marketing (Bird et al, 2003)..

A final example illustrates that involvement in international trade can generate benefits for the poor. A study of the Kenyan export horticulture shows that smallholder households who shifted into producing horticultural crops for export experienced a reduction in poverty (McCulloch, Ota and Humphrey, 2003). The study did not examine changes in income variability, non-income effects or intrahousehold distribution, however, it showed that access to international markets could result in improvements in *aggregate* household income.

Increased engagement with international markets can also affect livelihood choices indirectly through making inputs for some enterprises more readily available, at lower cost; by increasing demands for unskilled and semi-skilled labour, tightening the labour market and driving up wages. This will benefit some poor groups, but may damage emergent micro-entrepreneurs by increasing labour-related production costs and opening markets to competitive imports.

Pursuing the issue of wages, Robbins (1996) provides a synthesis of findings from studies which examine the impact of trade on wages in nine developing countries²⁴. He found that liberalisation resulted in rising demands for labour and increases in relative wages and average incomes.

5.9. Coping with risk, shocks and vulnerability.

Households and individuals spread risk and respond to an adverse event (or set of events) by changing their livelihood activities or consumption habits. These events or shocks may be internal to the household (e.g. illness of a household member) or external (e.g. collapse of coffee prices). The coping strategies adopted are likely to involve household members in a range of activities spread over time and space. The impact that these strategies have on income, consumption, assets or well-being will depend on the starting point of the individual or household, their experience of coping with adversity and the severity and duration of the shock (see Annex 1, Q7.4, Q7.10, Q7.13 and Annex 2, Q1.5).

The poor have been shown to design and sequence their coping strategies through experience of previous shocks to exploit or cash in their assets (e.g. their skills and labour, their access to common property resources, their social capital) to generate the highest short term returns while preserving the assets they value highly for as long as possible (Corbett, 1988; Chambers, 1989; Swift, 1989; and Scoones, 1992, 1996). However, for some coping may result in drawing down on assets in a way which leads to a downward spiral of well-being, increasing vulnerability and

²⁴ The countries are: Argentina, Uruguay, Chile, Costa Rica, Colombia, Mexico, the Philippines, Malaysia, and Chinese Taipei.

undermining productive assets. The asset endowments and capabilities of individuals and households are powerful determinants of whether they are able to adjust to the short and medium term costs of changes in trade (see Annex 2, Q1.8). Those who have a single livelihood activity which is based on highly specialised skills and a cluster of specific assets may find adaptation difficult. However, if their skills are transferable and they have a high degree mobility the short-run costs of change may be low. The poor, with few assets, are usually amongst the most vulnerable. However, a non-poor individual with low mobility, highly specified and non-transferable skills and assets will be vulnerable to shocks and may experience a significant loss of welfare which drives them and their household to attempt various coping strategies and ultimately into poverty following changes in trade. For example, workers in established industries may be older and less adaptable than those who will participate in new sectors. Also, craftsmen and artisans can have significant barriers to exit, based on their human and physical capital.

It is important that sub-sectors and livelihood groups who are likely to have a high degree of vulnerability are identified during the policy design process, in order that appropriate complementary policies can be designed and implemented.

By monitoring poor segments of the population, researchers should be able to identify whether changes in trade are forcing people into adverse coping. For example, increased returns to agriculture may result in the *de facto* privatisation of common lands or the felling of forests, reducing scope for the collection of wild foods or non-timber forest products; removal of import taxes may reduce the price of manufactured goods to international levels making some domestic industries uncompetitive and resulting in job losses which force households to adopt a range of coping strategies. Where these responses can be predicted (e.g. through analysis of normal elasticities or response to economic incentives) the government should put in place interventions to mitigate negative impacts. Where negative impacts were not predicted or where compensatory policies have not been designed and implemented, evidence of adverse coping should trigger government to implement social protection and other mechanisms.

5.10. Transfer income

As we have shown in the section above, trade reform creates winners and losers, and the losers are likely to respond to transitory short term adjustment costs by devising coping strategies. These are likely to include households and individuals claiming their entitlements to both formal and informal transfers in cash or kind (see Annex 2, Q1.9). Even if well targeted formal social protection systems are in place, they work best when responding to a severe crises. Government administrative systems do not tend to be alerted to unless certain thresholds are reached. Thresholds may be set high, and response may only be triggered by – for example – a certain number of proven hunger-related deaths. Interventions at this stage may be too late to preserve households' assets and moving household out of destitution often requires more complex and long-term interventions than preventing destitution in the first place. Informal or traditional systems may support people (for example through remittances of urban workers to their rural relatives), but they work best during peak seasons. It is therefore important to avoid the assumption that poor people will find a way of coping. Such assumptions can result in lazy policy making which relies on the ingenuity and resilience of the poor. The declining well-being of the poor may have low visibility and low political currency, so, unless changes from trade create problems which can either be accommodated by traditional systems or

are severe enough to register as a crisis, poor households may find that they are left unsupported.

Evidence from Turkey indicates that direct compensation mechanisms work well where sections of the population need to be protected from the negative impacts of trade liberalisation, even when accounting for the costs of raising revenue to cover the additional government expenditure (Harrison et al, 2000). However, in Kenya, although transfers were found to reduce the poverty of the target group, the programme had a negative impact on non-recipients because of the way that the programme was financed (Levin, 2000).

Researchers investigating the impact of changes in trade on the poor will need to review existing national social protection programmes. Such an assessment would need to combine and examination of evidence of negative coping amongst different groups of poor people with an evaluation of the effectiveness of existing social protection programmes. In assessing social protection systems, researchers need to review evidence of effectiveness²⁵ (is targeting too loose or too tight?, are declines in well-being prevented?) and efficiency (can the administration cope? are costs manageable?). Gupta et al (2000) suggest that well designed social protection systems might incorporate (1) targeted subsidies; (2) cash transfers (e.g. child allowances, fee waivers for basic services) – though these are rare in low income countries; (3) severance pay and retraining for retrenched workers in companies that can no longer compete (though such payments are unlikely to be available to workers in micro-enterprises and other informal sector firms), and (4) employment through public works, with appropriately set wages to ensure targeting of the truly needy.

6. Recommendations for how to take account of trade/ poverty interactions.

In the concluding section of this paper we consider the implications for government policy of the likely impact on the poor of changes in trade.

State capacity determines the ability to design and implement complementary policies independently. The identification of linkages between trade and poverty is a relatively new area. It is therefore reasonable to assume that skills in identifying and implementing good policy needs further development. This will involve some evolution in the policy formation and implementation process (Page, 2001). Successful complementary policies, combined with the quality of leadership, determine how skilfully a regime is able to negotiate and build consensus around its responses to globalisation (Tsikata, 2000).

Governments wishing to stimulate market development and production for trade will need to invest heavily in physical infrastructure and identify policies supportive of the development of rural financial markets.

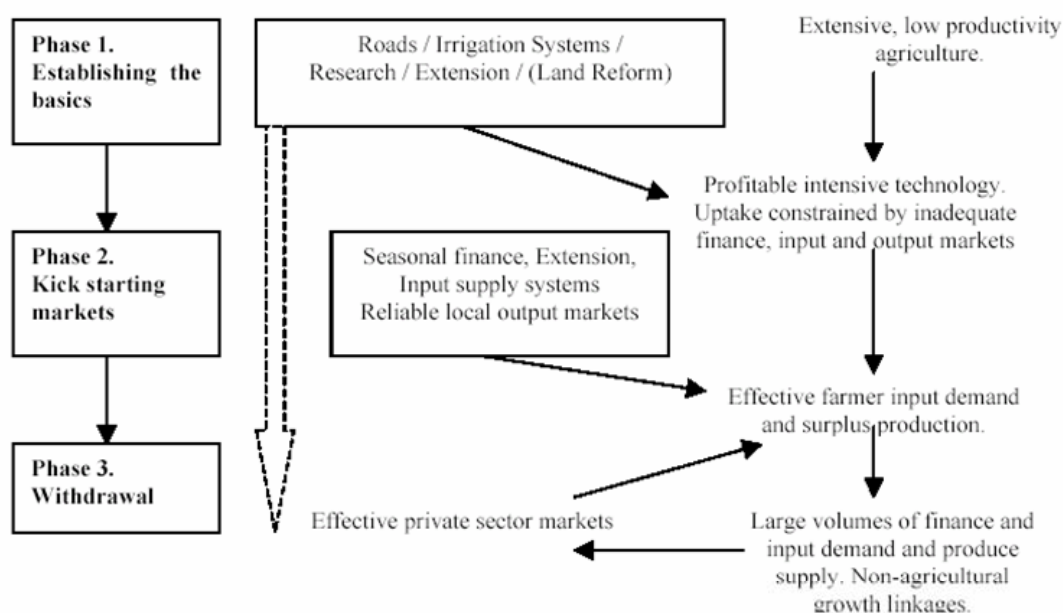
6.1 The sequencing of trade policy

²⁵ Note: some types of alternative income or employment schemes may have been designed for particular needs (by age or family structure) and may assume an even distribution across the economy. Trade-induced shocks may be concentrated on particular sectors and localities.

In many parts of Africa, governments are still substantially involved in the productive economy, either through parastatal involvement in the agricultural sector or through the maintenance of high tariff and administrative barriers to trade. Dorward (2004) suggests that in order to withdraw leaving a vibrant economy, the government should first 'establish the basics', including effective roads networks (see Figure 2, below). He also argues that without access to appropriate technology and effective credit and both input and output markets the withdrawal of the state will leave agricultural production in a state of collapse. This highlights the need for the careful sequencing of policy change.

Turning to the sequencing of liberalisation, there are debates as to whether the current account and the capital account should be liberalised simultaneously (see Falvey and Kim, 1992; Edwards, 1986; and Razin and Rose, 1992 in McCulloch et al, 2001). McCulloch et al conclude that full capital account liberalisation can put a country at risk, due to the high speed and large volume of capital movements (e.g. the Asian crisis of 1997-98). They therefore state that the consensus advice, particularly for poor countries, is to liberalise the current account first and then to cautiously liberalise the capital account.

Figure 2: Phases of support for agricultural transformation in favoured areas



Source: Dorward, 2004.

6.2 Including trade more effectively in PRSPs

The extent and depth of trade coverage in completed PRSPs is limited (Hewitt and Gillson, 2003). Issues like employment and wages are given attention, but the important linkages between these and production/ trade issues have been underplayed (ibid). Where PRSPs do contain a discussion on trade, few discuss anything more than simple export promotion measures and there is limited analysis to link trade and changes in poverty. There is an absence of *ex-ante* analysis, so the likely impact on the poor is unknown. Poverty analysis tends to be weak and does not disaggregate trade impacts on different groups of poor people. Non-income

aspects of poverty including risk and insecurity, access to services and empowerment are almost completely ignored.

Donors need to encourage countries revising their PRSPs to include more on trade, and to assess the likely impact of trade-policy changes on poverty. The framework presented in this paper should support in this process.

6.3 Mutually supportive trade and macro-economic policy

Research on Latin America has shown there to be a strong link between macroeconomic downturns and rising poverty. Every percentage point decline in growth results in a two percent increase in poverty. This is partly because of the irreversible impact that macroeconomic shocks can have on the human capital of the poor by damaging opportunities for investment in education, nutrition and health (Lustig, 2000). An awareness of this danger needs to be built into government macroeconomic and social protection policy while opening the economy to trade. Likewise, changes in trade policy can have significant impacts on the macro-economic performance of a country. As discussed above, trade reforms can have significant impacts on a country's fiscal balance. Substantial changes in income can also trigger either inflation or recession, if not managed carefully. Clearly, governments need to use the policy instruments available to them to ensure that the economy grows without dangerous levels of inflation and that macroeconomic policies are implemented to promote trade and growth.

6.4 Complementary policies for other sectors

Complementary policies will often include investments in infrastructure health, education and social protection, in addition to reforms that will stimulate and enable the private sector in the agriculture, power, telecoms and financial sectors and more widely across the economy. Such reforms will enable production to reach its potential and will allow a robust supply response to the price signals sent by international markets.

Poor producers are likely to see their livelihoods in inefficient sectors disappear. Unless transitional arrangements and social protection measures are put in place poverty incidence and severity will increase still further. Investments are necessary to support individuals to find more reliable sources of livelihood. These are likely to include transitional training and advisory services, and incentives for the location of the private sector.

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