PART 1

TRADE FOR HUMAN DEVELOPMENT

CHAPTER 1
HUMAN DEVELOPMENT AND TRADE

Trade and human development have a complex relationship. Understanding their interaction requires understanding the complexity of trade policy and human development as part of broader development policy.

Though the relationship between trade and development is the subject of contentious debate in the literature, there is little doubt that trade can be a powerful source of economic growth. But while broadly based economic growth is necessary for human development, it is not enough. Human development also requires enlarging people's choices and opportunities—especially poor people's.

International trade can expand markets, facilitate competition and disseminate knowledge, creating opportunities for growth and human development. Trade can also raise productivity and increase exposure to new technologies, which can also spur growth. Indeed, over the past 20 years the fastest-growing regions have also had the highest export growth.[1]

But liberalizing trade does not ensure human development, and expanding trade does not always have a positive or neutral effect on human development. Trade expansion neither guarantees immediate economic growth nor longer-run economic or human development. Internal and external institutional and social pre-conditions largely determine whether and to what extent a country or population group benefits from trade.

This chapter begins by discussing the many dimensions of human development. It then identifies how trade is linked, directly or indirectly, to human development. After that it discusses important policy questions: the relationship between trade liberalization, economic growth and human development, and the role of trade in broader industrialization and development strategies. The chapter concludes with a few key messages that provide the framework for the rest of the book.

HUMAN DEVELOPMENT—THE CONCEPT AND ITS IMPLICATIONS

People are the real wealth of nations, and the main goal of development is to create an enabling environment for people to enjoy long, healthy, creative lives. This may appear to be a simple truth. But for too long, development efforts have focused on creating financial wealth and improving material well-being. Forgotten in such pursuits is that development is about people. The preoccupation with economic growth has pushed people to the periphery of development discussions.

The first *Human Development Report*, published by the United Nations Development Programme (UNDP) in 1990, tried to reverse that trend. With its concept of human development, construction of a measure for it and discussion of the policy implications, the report changed how the world looked at development.

Defining human development

People constantly make choices—economic, social, political, cultural. The ultimate aim of development is not to create more wealth or to achieve higher growth. It is to expand the range of choices for every human being. Thus human development is concerned with enlarging choices and enhancing their outcomes—and with advancing basic human freedoms and rights. Defined in this way, human development is a simple notion with far-reaching implications.

- People's choices are enlarged if they acquire more capabilities and have more opportunities to use them.
- Choices are important for current as well as future generations. For human development to be sustainable, today's generations must enlarge their choices without reducing those of future generations.
- Though important, economic growth is a means of development—not the ultimate goal (box 1.1). Higher income makes an important contribution if it improves people's lives. But income growth is not an end. Development must be focused on people, and economic growth must be equitable if its benefits are to be felt in people's lives.
- Gender equality is at the core of human development. A development process that bypasses half of humanity—or discriminates against it—limits women's choices.
- By focusing on choices, the human development concept implies that people must participate in the processes that shape their lives. They must help make and implement decisions and monitor their outcomes.
- Human security is distinct from but contributes to human development (UNDP, 1994). Security means safety from chronic hunger, disease and repression. It also means protection from sudden, harmful disruptions in the patterns of daily life. In an economic context, it protects people from threats to their incomes, food security and livelihoods.

Looking at development through a human development lens is not new. The idea that social arrangements must be judged by how much they promote human goods dates back to at least Aristotle, who said: 'Wealth is evidently not the good we are seeking, for it is merely useful and for the sake of something else.' He argued for seeing the 'difference between a good political arrangement and a bad one' in its successes and failures in facilitating people's ability to lead 'flourishing lives'

BOX 1.1 ECONOMIC GROWTH AND HUMAN DEVELOPMENT

Economic growth is necessary but insufficient for human development. And the quality of growth, not just its quantity, is crucial for human well-being. Growth can be jobless, rather than job creating; ruthless, rather than poverty reducing; voiceless, rather than participatory; rootless, rather than culturally enshrined; and futureless, rather than environmentally friendly. Growth that is jobless, ruthless, voiceless, rootless and futureless is not conducive to human development.

Source: Jahan, 2000.

(cited in UNDP, 1990). Seeing people as the real end of all activities was a recurring theme in the writings of most early philosophers.

The same concern can be found in the writings of the early leaders on quantification in economics: William Petty, Gregory King, Francois Quesnay, Antoine Lavoisier and Joseph Lagrange, the grandparent of the concepts of gross national product (GNP) and gross domestic product (GDP). It is also clear in the writings of the leading political economists: Adam Smith, David Ricardo, Robert Malthus, Karl Marx and John Stuart Mill.

The human development concept is an extension of that long tradition, and is broader than other people-oriented approaches to development. The human resource approach emphasizes human capital and treats human beings as inputs into the production process, not as its beneficiaries. The basic needs approach focuses on people's minimum requirements, not their choices. The human welfare approach looks at people as recipients, not as active participants in the processes that shape their lives.

Human development treats people as the subject of development, not the object. It is both distinct from and more holistic than other approaches to development. Development of the people builds human capabilities. Development for the people translates the benefits of growth into people's lives. And development by the people emphasizes that people must actively participate in the processes that shape their lives.

As a holistic concept, human development is broader than any of its measures, such as the human development index. In principle, human choices can be infinite and change over time. But three essential choices are those that allow people to lead long and healthy lives, to acquire knowledge and to have access to resources for a decent standard of living. The human development index measures these three basic dimensions of human development.[2] Though not comprehensive, it is better than other economic measures—such as per capita income—in assessing human well-being.[3]

The objectives of human development were recently codified in the Millennium Development Goals (UN, 2000). The goals set numerical, time-bound targets for advancing human development in developing countries, including halving extreme income poverty and hunger, achieving universal primary education and gender equality in primary education, reducing under-5 mortality by two-thirds and maternal mortality by three-quarters, reversing the spread of HIV/AIDS and other major diseases, and halving the portion of people without access to safe water. These targets are to be achieved by 2015, with reductions based on levels in 1990.

Human poverty

If income is not the sum total of human development, lack of it cannot be the sum total of human deprivation. So, from a human development perspective, poverty is also multidimensional. Beyond lack of income, people can be deprived if they lead short and unhealthy lives, are illiterate, feel personal insecurity or are not allowed to participate. Thus human poverty is larger than income poverty.

Human poverty is more than just a state: it is a process. People living in poverty deploy whatever assets they have to cope with it. A dynamic phenomenon reproduced over time and across generations, poverty is also the result of structural inequalities and discrimination—based on class, race, gender and other characteristics—within and between countries.

Gender is among the most important determinants of power in society.[4] This is reflected in institutions, including markets and the state, which transmit gender biases into economic outcomes. In most societies women work more than men, earn less, receive less schooling and face greater obstacles to accessing wealth, credit, information and knowledge.[5] Thus gender inequalities are a fundamental obstacle to human development (Çağatay, Elson and Grown, 1995; Grown, Elson and Çağatay, 2000). Gender influences economic behaviour, and gender relations influence the distribution of output, work, income, wealth and power.

The relationship between gender and poverty goes both ways. Gender inequalities influence the relationship between macro-economic and trade policies and their outcomes. Gender also affects growth performance and so poverty. Labour is poor people's most abundant asset. But women have less control than men over their labour and income. Moreover, labour remains partly invisible as long as unpaid household work, performed mostly by women, is not considered part of economic activity.[6]

In some cases men may forbid their wives from working outside the home.[7] In others men may extract labour from women through actual or threatened violence, as with unpaid female family workers. During crises men are generally able to mobilize women's labour, but women lack the reciprocal ability to mobilize men's. For these reasons and others it is harder for women to transform their capabilities into income and well-being (Kabeer, 1996).

Linking trade and human development

Trade can generate significant static welfare gains by increasing allocative efficiency, raising capacity use, achieving scale economies in production and making a wider variety of products available for consumption (box 1.2). But none of these

BOX 1.2 TRADE THEORY

Few branches of the literature on economics are richer or more controversial than that on international trade. There has been little consensus on the relationship between trade and short- to medium-term economic growth—and even less on its role in long-term economic development.

The principle of comparative advantage, first described by David Ricardo, forms the theoretical basis for traditional trade theory and provides the rationale for free trade. The principle states that even if a country produced all goods more cheaply than other countries, it would benefit by specializing in the export of its relatively cheapest good (or the good in which it has a comparative advantage).

Some classical economists believed that comparative advantage was driven by differences in production techniques. Later theoretical developments identified differences in factor endowments as the principal basis for comparative advantage. Traditional trade analysis acknowledged the argument for policy intervention (protectionism) if market failures created a need for temporary protection of infant industries—though direct subsidies were still considered preferable. Intervention was also justifiable, though still discouraged, if it could improve a nation's terms of trade by deploying market power. But these were exceptions to the general principle that free trade is best.

Traditional trade theory has been challenged because it often cannot explain actual trade patterns. Careful empirical investigations show that many of the theory's basic assumptions—perfect competition, full employment, perfect factor mobility within countries, immobile factors between countries—are unrealistic and do not conform to theoretical predictions. When these assumptions are relaxed, welfare and other outcomes are less clear. Moreover, the introduction of assumptions on differential learning effects, positive externalities and technical changes associated with different economic activities creates the theoretical possibility of weak (if any) gains from trade for countries that specialize in low value-added, labour-intensive products.

Several analysts have tried to modify, expand or reject some of the conclusions of traditional trade theory. New trade theorists cite the role of scale economies and imperfectly competitive markets in determining intra-industry trade patterns among industrial countries. This view led strategic trade theorists to argue for subsidizing certain industries, to give them strategic advantage in oligopolistic international markets. The recent literature on trade and growth also emphasizes that, in dynamic terms, comparative advantage can be created based on human capital, learning, technology and productivity. It can also change over time based on economic policy.

Other responses come from theorists who question the validity of the comparative advantage principle, arguing that absolute or competitive advantage is a more reliable determinant of trade outcomes. One such response is a macro-level analysis that looks at trade in the context of low aggregate demand, structural unemployment and inflexible wage adjustments. Another argues that international industrial competitiveness is determined by the technology gaps between nations.

The common thread in these different theories is that trade can contribute to growth by expanding markets, facilitating competition and disseminating knowledge. Controversy continues to surround the efficacy of growth-promoting policy intervention. And the trade literature says little about how trade and trade policy relate to human development over time.

Source: UNDP, 2002.

benefits are guaranteed, and trade can impose hefty adjustment costs for certain segments of the population and, in some cases, for the economy as a whole. Trade also has dynamic effects, but it is less clear how trade affects economic growth and growth then affects human development.

Links between growth and human development

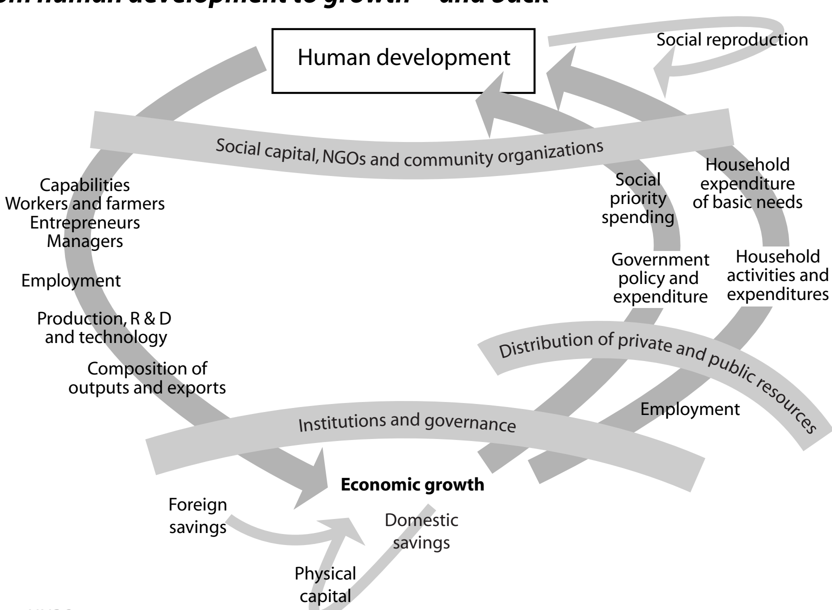
Conventional wisdom holds that economic growth links trade to human development. But there is no automatic relationship between growth and human development. While 'economic growth expands the material base for fulfilling human needs' (UNDP, 1996, p. 66), the extent to which those needs are met depends on resource allocations and on the creation of opportunities for all parts of the population.

Still, in the long run, economic growth and human development tend to move together and be mutually reinforcing. Growth can contribute to human development in two ways (figure 1.1). First, employment-led growth raises household income. Depending on how it is spent, the additional income can be used to improve nutrition, augment children's education or increase skills—all of which enhance human capabilities. The extent to which household income is spent on human development partly depends on who controls it. If women control it, it is more likely to be spent on health, nutrition and education.

Second, growth can contribute to human development through government policies and spending. Growth can increase government revenue—which, if used to reduce income inequality and enhance health and education, benefits human development.

FIGURE 1.1

From human development to growth—and back



Source: UNDP, 1996.

Other links between trade and human development

Beyond its direct benefits for human development through economic growth, trade can enlarge people's choices by expanding markets for goods and services and by providing stable incomes for households. In addition, increased employment leads to higher incomes that, if spent on health and education, enhance people's capabilities.

Although trade has an ambiguous effect on the distribution of wealth, governments can harness trade's economic benefits to increase equity among different groups. In many developing countries large parts of the population do not participate in the formal economy and markets. Without mechanisms to distribute the gains from trade, poor and vulnerable people are unlikely to benefit. Ownership patterns will be reinforced, leaving few opportunities for widespread gains.

Trade policies also reflect and affect gender relations. Similarly, trade's effects on women and men vary, depending in part on gender relations: increased trade can expand female employment but does not automatically lead to higher wages or more secure jobs. Indeed, trade can increase women's work burden.

Trade also affects other aspects of human development. Deeper integration with the global economy can make developing countries more vulnerable to external shocks. In many developing countries trade liberalization has resulted in deteriorating terms of trade—and in some even immiserizing growth, where increased export production is not absorbed in world markets, causing severe damage to terms of trade and a loss in real income. In many developing countries trade liberalization has also increased volatility, threatening the security of livelihoods and incomes. But trade can also increase people's economic participation by providing jobs as well as access to credit and markets for goods. Such developments empower people and so can foster political participation.

The two-way relationship between human development and trade

The links running the other way—from human development to growth, and its relationship with trade—are just as important. Better human development outcomes, in the form of improved capabilities as the result of a healthier, better-educated and more skilled work force, with a strong focus on knowledge creation, contribute to higher economic growth and better trade outcomes.

But countries with low social and economic indicators are generally compelled to export primary or low value-added products. Over the long run such exports often fail to raise skill levels and productivity and seldom stimulate technological change. Thus, unlike wealthier countries, poor countries with low literacy, weak infrastructure and other supply-side constraints may have limited capacity to benefit from trade. On the other hand, countries that invest in building people's capabilities can engage in production and trade that raise productivity, which can generate a virtuous cycle of better human development and trade.

This potential for a mutually reinforcing relationship makes trade an important means of achieving better human development outcomes. As a result trade's effect on growth—and the converse—is often a useful proxy for its effect on human development.

Is trade liberalization good for growth and human development?

Trade liberalization is the common policy prescription for increasing trade flows. The voluminous literature in this area forms the basis for often-heard claims about the benefits of trade openness. But that literature is far from unequivocal. There is no convincing evidence that trade liberalization is always associated with economic growth.[8] Thus there is no evidence that trade liberalization is inevitably good for human development.

Consider Viet Nam and Haiti. Since the mid-1980s Viet Nam has taken a gradual approach to economic reform, following a two-track programme. It engages in state trading, maintains import monopolies, retains quantitative restrictions and high tariffs (30–50 per cent) on agricultural and industrial imports and is not a member of the World Trade Organization (WTO). Yet it has been phenomenally successful, achieving GDP growth of more than 8 per cent a year since the mid-1980s, sharply reducing poverty, expanding trade at double-digit rates and attracting considerable foreign investment. And despite high trade barriers, it has rapidly integrated with the global economy.

Haiti, meanwhile, undertook comprehensive trade liberalization in 1994–95, has slashed import tariffs to a maximum of 15 per cent and has removed all quantitative restrictions (US Department of State, 1999). Yet its economy has gone nowhere, and its social indicators are deteriorating. And despite being a WTO member, it has made little progress in integrating with the global economy.

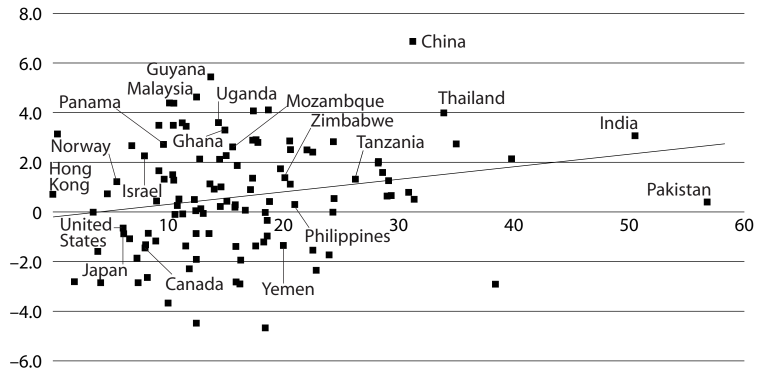
These countries' contrasting experiences highlight two points. First, leadership committed to development and supporting a coherent growth strategy counts for a lot more than trade liberalization—even when the strategy departs sharply from the 'enlightened' standard view on reform.[9] Second, integration with the world economy is an outcome, not a prerequisite, of a successful growth strategy. Protected Viet Nam is integrating with the global economy much faster than open Haiti, because Viet Nam is growing and Haiti is not.

This comparison illustrates a common misdiagnosis. A typical World Bank exercise consists of classifying developing countries into 'globalizers' and 'non-globalizers' based on their rates of growth in trade volumes. The analyst asks whether globalizers (those with the highest rates of trade growth) have faster income growth, greater poverty reduction and worsening income distribution (see Dollar and Kraay, 2000). The answers tend to be yes, yes and no. But as Viet Nam and Haiti show, this approach is misleading. Trade volumes are the outcome of

FIGURE 1.2

Low import tariffs are good for growth? Think again

Annual average per-capita GDP growth rate during the 1990s
(unexplained part, per cent) vs. average import tariff rate (per cent)



Note: All data are averages for the 1990s. Specifications are based on Dollar and Kraay (2000), replacing trade–GDP ratios with tariff levels and controlling separately for inflation, initial income and government consumption as a share of GDP.
Source: Dollar and Kraay, 2000.

many things—including, most important, an economy's overall performance. They are not something that governments control directly. What governments control are trade policies: levels of tariff and non-tariff barriers, membership in the WTO, compliance with its agreements and so on. The relevant question is, do open trade policies reliably produce higher economic growth, greater poverty reduction and more human development?

Cross-national comparisons reveal no systematic relationship between countries' average levels of tariffs and non-tariff barriers and their subsequent economic growth. If anything, evidence for the 1990s indicates a positive (but statistically insignificant) relationship between tariffs and economic growth (figure 1.2). The only systematic relationship is that countries dismantle trade barriers as they get richer. That accounts for the fact that with few exceptions, today's rich countries embarked on economic growth behind protective barriers but now have low barriers.

The absence of a robust positive relationship between open trade policies and economic growth may come as a surprise given the ubiquitous claim that trade liberalization promotes higher growth. Indeed, the literature is replete with cross-country studies concluding that growth and economic dynamism are strongly linked to more liberal trade policies. For example, an influential study by Sachs and Warner (1995) found that economies that were open (by the authors' definition) grew 2.4 percentage points a year faster than economies that were not—an enormous difference. Without such studies, organizations such as the World Bank, International Monetary Fund and WTO could not have been so vociferous in their promotion of trade-centred development strategies.

But such studies are flawed. The classification of countries as 'open' or 'closed' in the Sachs-Warner study, for example, is not based on actual trade policies but largely on indicators related to exchange rate policy and location in Sub-Saharan Africa. The authors' classification of countries conflates macroeconomics, geography and institutions with trade policy. The classification is so correlated with plausible alternative explanatory variables—macroeconomic instability, poor institutions, location in Africa—that one cannot draw from the empirical analysis any strong inferences about the effects of openness on growth (Rodriguez and Rodrik, 2001).

This problem is widespread. In a review of the best-known literature (Dollar, 1992; Ben-David, 1993; Edwards, 1998; Frankel and Romer, 1999; Sachs and Warner, 1995), Rodriguez and Rodrik (2001) found major gaps between the policy conclusions drawn and what the research actually showed. A common shortcoming is the misattribution of macroeconomic phenomena (overvalued currencies or macroeconomic instability) or geographic location (in the tropical zone) to trade policies. Once these problems are corrected, any meaningful cross-country relationship between trade barriers and economic growth evaporates (Helleiner, 1994).

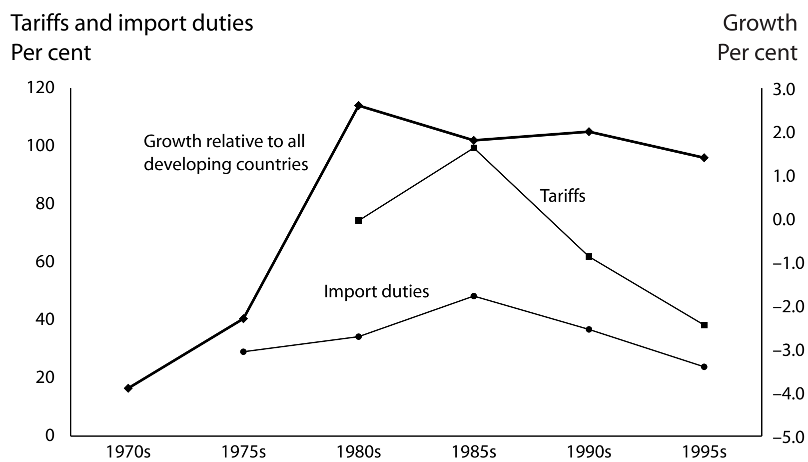
In reality, the relationship between trade openness and growth is likely to be contingent on a host of internal and external factors. That nearly all of today's industrial countries embarked on their growth behind tariff barriers, and reduced protection only subsequently, surely offers a clue. Moreover, the modern theory of endogenous growth yields an ambiguous answer to the question of whether trade liberalization promotes growth—one that depends on whether the forces of comparative advantage push an economy's resources towards activities that generate long-run growth (conducting research and development, expanding product variety, upgrading product quality and so on) or divert them from such activities.

No country has developed successfully by turning its back on international trade and long-term capital flows. And few have grown over long periods without experiencing an increase in the share of foreign trade in their national product. The most compelling mechanism linking trade to growth in developing countries is that imported capital goods are likely to be much cheaper than those manufactured at home. Policies that restrict imports of capital equipment and raise the prices of capital goods at home—and so reduce real investment—must be viewed as undesirable on the face of it (though this does not rule out the possibility of selective 'infant' industry protection in certain segments of capital goods industries). Exports, in turn, are important because they permit purchases of imported capital equipment.

But it is also true that no country has developed simply by opening itself to foreign trade and investment. The trick has been to combine the opportunities offered by global markets with strategies for domestic investment and institution building, to stimulate domestic entrepreneurs. Nearly all the cases of development

FIGURE 1.3

Tariffs did not impede growth in India



Source: Rodrik, 2001, using data in Dollar and Kraay, 2000 and World Bank, *World Development Indicators 2000*, 2000.

in recent decades—East Asia since the 1960s, China and India since the early 1980s—have involved partial, gradual opening to imports and foreign investment.

China and India are particularly noteworthy. Both countries are huge, have done extremely well economically, and are often cited as examples of what openness can achieve (see Stern, 2000, p. 3). But again, the reality is more complicated. China and India implemented their main trade reforms about a decade after the onset of higher growth. Moreover, their trade restrictions remain among the highest in the world. The increase in China's growth started in the late 1970s. Trade liberalization did not start in earnest until much later, in the second half of the 1980s and especially in the 1990s—once the trend growth rate had already increased substantially.

India's growth rate increased substantially in the early 1980s, while serious trade reform did not start until 1991–93. Tariffs were actually higher in the higher-growth period of the 1980s than in the low-growth 1970s (figure 1.3). Although tariffs are hardly the most serious trade restrictions in India, they reflect trends in its trade policy fairly accurately.

Both China and India participated in international trade during the 1980s and 1990s, so by that measure they are both globalizers. But the relevant question for policy-makers is not whether trade is good or bad: countries that achieve rapid growth also see trade accounting for a growing share of GDP. The question is the correct sequence of policies and how much priority deep trade liberalization should receive early in the reform process. China and India suggest the benefits of a gradual, sequenced approach.

The point here is not that trade protection is inherently preferable to trade liberalization. Certainly, there is scant evidence from the past 50 years that inward-looking economies experience faster growth than open ones. But the benefits of trade openness have been greatly oversold. Deep trade liberalization cannot be relied on to deliver high economic growth and so does not deserve the high priority it receives in the development strategies pushed by leading multilateral institutions.[10]

As Helleiner (2000, p. 3) puts it, there are 'few reputable developing country analysts or governments who question the positive potential roles of international trade or capital inflow in economic growth and overall development. How *could* they question the inevitable need for participation in, indeed a considerable degree of integration with, the global economy?' (emphasis in original). The real debate is not over whether integration is good or bad, but over policies and priorities: 'It isn't at all obvious *either* (1) that further external liberalization ('open-ness') is now in every country's interest and in all dimensions *or* (2) that in the over-arching sweep of global economic history what the world now *most* requires is a set of global rules that promote or ease the path to greater freedom for global market actors, and are universal in application' (Helleiner, 2000, p. 4, emphasis in original).

Does trade liberalization improve gender outcomes?

Trade liberalization has had mixed results for gender outcomes, especially in developing countries.[11] Increased female employment is the main benefit that open trade provides for women. But there are others, including higher consumption and legislative improvements (Gammage and Fernandez, 2002). In addition to altering the gender composition of the work force (composition effect), trade policy and performance change working conditions (compensation effect).

Trade liberalization may increase female employment in two ways. First, female workers tend to be concentrated in certain industries and sectors—and increased international competition causes female-intensive sectors to expand and male-intensive sectors to decline (Elson, 1996). Second, intensified competition and supply-side macroeconomics and deregulation push employers to look for more flexible sources of labour. Because women's wages and other working standards (such as unionization) tend to be lower than men's, female labour is substituted for male labour—increasing employment for women (Standing, 1989; Standing, 1999).

Over the past two decades the share of women in the work force has risen steadily around the world. In Africa, Asia and Latin America more than 900 million women are economically active, accounting for 39 per cent of the economically active population (ILO, 2001). Women's paid employment due to liberalization seems to have increased—with mixed results. Employment increases women's autonomy and negotiating power (Çağatay, 2001). But export-oriented jobs for women often pay low wages and involve poor working conditions, so the net effect has not necessarily been positive.

Institutional structures, coupled with patriarchal gender norms and stereotypes, limit women's bargaining power and generate the large (and growing) gender-based wage gap (Seguino, 2000). Weakening rights for workers in general and for women in particular—often due to labour market deregulation—also affect areas other than low wages and unfavourable working conditions. Employment has become increasingly insecure (due to unstable, unpredictable world markets), increasingly intense and increasingly hazardous (with both health and safety risks). It also shows increasing disregard for labour required in the household, especially child care.

Repetitive, low-skill work locks women into dead-end jobs. And when production calls for higher skills or technological sophistication, women are replaced by men. Employment in the electronics industry in the Republic of Korea and in the *maquiladoras* in Mexico, for example, has shifted in favour of men (UN, 1999).

Although trade liberalization and export-oriented policies have increased women's paid employment in developing countries, there has not been a corresponding decrease in their household and care responsibilities, contributing to their 'triple burden'. In Bangladesh increased women's employment has been accompanied by reduced leisure time (Fontana and Wood, 2000). This pattern implies that liberalization has also adversely affected care, jeopardizing long-term human development (UNDP, 1999).

Governments can influence how trade liberalization affects women's well-being. For example, some countries have cut spending on social services in part because of lower revenue from trade taxes. Such cuts hurt women disproportionately because they must make up for the reduction in health care, safe water and the like by increasing their (unpaid) household work and care.

How do gender inequalities affect trade performance?

Evidence from Asia suggests that the fastest-growing economies have had the widest gender-based wage gaps (Seguino, 2000). While most dimensions of gender inequality (health, education, skills training) constrain productivity and growth, wage inequality appears to have aided growth by increasing international competitiveness. Indeed, in some export-oriented semi-industrial countries, gender inequalities in manufacturing wages have stimulated investment and exports. Lower labour costs free resources to purchase capital and intermediate goods and advanced technology, leading to higher growth.

If used extensively, however, a competition strategy based on lower wages for women could cause steady deterioration in the terms of trade of developing relative to industrial countries—especially in female-intensive manufactured exports—if export prices reflect the true cost of such wages.[12] On the other hand, Joekes (1999, p. 55) points out that 'low wages paid to women workers have allowed the final product prices to be lower than what they would otherwise have been without compro-

BOX 1.3 TRADE, POVERTY AND GROWTH IN THE LEAST DEVELOPED COUNTRIES

The world's 49 least developed countries suffer from extreme poverty and underdevelopment. During 1995–99 half of the people in these countries lived on less than $1 a day, and four-fifths lived on less than $2 a day. International trade plays a crucial role in these countries' economies. In 22 of the 39 for which data are available, trade accounts for more than half of GDP—a larger share than in high-income OECD countries.

In 1997–98 imports equalled 26 per cent of GDP in the least developed countries, considerably more than the 17 per cent for exports. This imbalance is reflected in the group's trade deficit, which is much higher than the deficits for other groups of countries. Among the least developed countries, trade varies greatly depending on whether countries export primary products, non-oil primary products, or manufactured goods. Primary product exporters have the highest poverty; with more than 80 per cent of the people in mineral-exporting countries living on less than $1 a day at the end of the 1990s, compared with 43 per cent in service exporters and 25 per cent in manufactured goods exporters (excluding Bangladesh).

There is little correlation between trade liberalization and poverty reduction: poverty appears to be increasing unambiguously in the least developed countries with the most open and the most closed trade regimes. But between those extremes poverty is also increasing in countries that have liberalized trade more. While these findings do not prove that liberalization increases poverty, they do show that liberalization does not automatically reduce poverty.

The least developed countries that experienced economic growth in the 1990s also became more export oriented. But that does not mean that increased export orientation was associated with growth: GDP per capita declined or stagnated in 8 of the 22 least developed countries with increasing export orientation between 1987 and 1999. And in 10 of these countries poverty increased. Sustained economic growth is the key to reducing poverty in the least developed countries: 14 with rising GDP per capita saw poverty fall. So, unless accompanied by sustained growth, greater export orientation was not associated with reduced poverty.

Source: UNCTAD, 2002a, ch 3.

mising the profit share'. Developing and industrial countries export different kinds of manufactured goods, with developing countries oriented towards standardized commodities that require fewer skills (UNCTAD, 2002b). Manufactured exports also differ in the gender composition of the workers who produce them, with developing country exports more female-intensive than industrial country exports. Osterreich (2002) finds that gender-based wage gaps are associated with worse terms of trade in semi-industrial countries than in industrial countries.

WHAT REALLY MATTERS FOR TRADE AS PART OF A BROADER INDUSTRIALIZATION AND DEVELOPMENT STRATEGY

Should governments pursue economic growth first and foremost? Or should they focus on reducing poverty? Recent debate on this issue has become embroiled in broader political controversies on globalization and its impact on developing economies.[13] Critics of the WTO accuse it of being overly concerned about economic

TABLE 1.1

The Washington Consensus

The original Washington Consensus	
Fiscal discipline	*Trade liberalization*
Reorientation of public spending	*Openness to foreign direct investment*
Tax reform	*Privatization*
Financial liberalization	*Deregulation*
Unified and competitive exchange rates	*Secure property rights*
The augmented Washington Consensus	
The original list plus:	
Legal and political reform	*Financial codes and standards*
Regulatory institutions	*'Prudent' capital account opening*
Anti-corruption efforts	*Non-intermediate exchange rate regimes*
Labour market flexibility	*Social safety nets*
World Trade Organization agreements	*Poverty reduction*

Source: Rodrik, 2001.

activity and growth at the expense of poverty reduction. Supporters argue that expanded trade and higher growth are the best ways to reduce poverty. But this largely sterile debate diverts attention from the real issues.

The real question is (or should be) whether open trade policies are a reliable way of generating self-sustaining growth *and* poverty reduction—evidence for which is far from convincing. Despite a voluminous literature, almost nothing is known about which kinds of trade policies are conducive to growth. In the least developed countries, for example, standard policy prescriptions over the past two decades have advocated trade liberalization as a way out of poverty. But there is little evidence to back that claim (box 1.3).

Today's enlightened standard view of development policy emerged from dissatisfaction with the limited results yielded by the Washington Consensus policies of the 1980s and 1990s. Disappointing growth and increasing economic volatility in Latin America (the region that went furthest with privatization, liberalization and openness), failures in the former Soviet Union and the East Asian financial crisis of 1997–98 contributed to a refashioning, resulting in the augmented Washington Consensus (table 1.1). This new approach goes beyond liberalization and privatization to emphasize the need to create the institutional underpinnings of market economies. Reforms now include labour market flexibility, social safety nets, financial sector regulation and prudential supervision, and governance, corruption, legal and administrative measures.

These institutional reforms are heavily influenced by an Anglo-American conception of what constitutes desirable institutions, as with the preference for arm's-length finance over 'development banking' and for flexible over institutionalized labour markets. The reforms are also driven by the requirements of integration with the global economy. Hence their emphasis on international harmonization of regulation, as with financial codes and standards and through WTO agreements.

Market economies rely on a wide array of non-market institutions that perform regulatory, stabilizing and legitimizing functions (Rodrik, 2000). The quality of a country's public institutions is a crucial—perhaps the most important—determinant of its long-term development (Acemoglu, Johnson and Robinson, 2000). Thus the recent emphasis on institutions is highly welcome. But there is no universal institutional foundation for a market economy: that is, no single form defines the non-market institutions required to sustain a well-functioning market, as is clear from the wide variety of regulatory, stabilizing and legitimizing institutions in today's advanced industrial countries. US capitalism is very different from Japanese capitalism, and both differ from the European style. And even in Europe, there are big differences between the institutional arrangements in, say, Germany and Sweden. Yet over the long term, all have performed well.[14]

This point about institutional diversity has a more fundamental implication. As Roberto Unger (1998) argues, today's varied institutional arrangements are merely a subset of the full range of institutional possibilities. There is no reason to believe that modern societies have exhausted all the institutional variations that could underpin healthy, vibrant economies. Analysts must avoid thinking that a specific type of institution—whether, for example, a mode of corporate governance, system for social security or legislation for the labour market—is the only one compatible with a well-functioning market economy.

Leaving aside the issue of choice on institutional forms, the 'enlightened' standard view, as a model for stimulating economic growth, suffers from a fatal flaw: it identifies no priorities among a long and demanding list of institutional prerequisites. This all-encompassing approach to development strategy is at odds with the historical experiences of today's advanced industrial countries. What are today considered key institutional reforms in such areas as corporate governance, financial supervision, trade law and social safety nets did not occur in Europe or North America until late in the economic development process (Chang, 2000). Indeed, many items on the augmented Washington Consensus agenda should be seen as outcomes of successful development, not prerequisites.

The factors underpinning economic growth are driven by an initially narrow set of policy and institutional initiatives that can be called 'investment strategies' (Rodrik, 1999). Adequate human resources, public infrastructure, social peace and political and economic stability are key elements of such strategies. But the critical factor is often targeted policy interventions that motivate domestic investors. Investment strategies set off a period of economic growth that facilitates institutional development and further growth. The initiating reforms are rarely replicas of each other, and they bear only partial resemblance to the requirements highlighted by the 'enlightened' standard view of development policy. Typically, they mix orthodox approaches with unconventional domestic innovations.

Analysis of three investment strategies elucidates this central point and highlights different paths to industrialization and prosperity: import substitution, East Asian–style outward orientation and two-track strategies. This list is by no means exhaustive, and future successful strategies will likely differ from all three.

Import-substituting industrialization

Import-substituting industrialization is based on the idea that domestic investment and technological capabilities can be spurred by providing domestic producers with (temporary) protection against imports. Although this approach has fallen into disgrace since the 1980s, it worked quite well for a long time in scores of developing nations. Until the oil shock in 1973, at least 42 developing countries had experienced per capita growth of more than 2.5 per cent a year since 1960 (see Rodrik, 1999, ch 4). At that rate per capita incomes would double at least every 28 years. Most of these countries used import-substituting industrialization policies, including 15 in sub-Saharan Africa, 12 in South America and 6 in the Middle East and North Africa. Until 1973, in fact, 6 sub-Saharan countries were among the world's 20 fastest-growing developing countries.[15]

Import-substituting industrialization catalysed growth by creating protected—and so profitable—home markets for domestic entrepreneurs to invest in. Contrary to received wisdom, this approach did not produce technological lags and large inefficiencies in economies of scale. Indeed, compared with today the productivity of many Latin American and Middle Eastern countries was exemplary. According to Collins and Bosworth (1996), during the period preceding the first oil shock total factor productivity growth was quite high in the Middle East (2.3 per cent a year) and Latin America (1.8 per cent)—and significantly higher than in East Asia (1.3 per cent).[16]

The dismal reputation of import substitution is partly due to the subsequent economic collapse (in the 1980s) in many of the countries that pursued it and partly to the influential studies of Little, Scitovsky and Scott (1970) and Balassa (1971). Those studies documented some of the static economic inefficiencies generated by high and extremely dispersed effective rates of protection in the manufacturing sectors of the countries under study. The discovery of cases of negative value added at world prices—that is, cases where countries would have been better off throwing away inputs rather than processing them in highly protected plants—was particularly shocking.

But neither study showed that countries that had followed outward-oriented strategies were immune from such inefficiencies. In fact, there was no clear difference between the performance of outward-oriented and import-substituting countries.[17] In addition, the data above on growth in total factor productivity show that it is wrong to assume that inward orientation produced more dynamic inefficiency than did outward orientation.

So, as an industrialization strategy intended to raise domestic investment and enhance productivity, import substitution worked fairly well in a broad range of countries until at least the mid-1970s. But starting in the second half of the 1970s, disaster struck in most of the economies that had been doing well. Only 12 of the 42 developing countries with growth rates above 2.5 per cent between 1960–73 were able to maintain them over the next decade (1973–84). The Middle East and Latin America, which had led the developing world in total factor productivity growth until 1973, began to experience negative average growth in productivity. East Asia held steady, while South Asia improved its performance (Collins and Bosworth, 1996).

Did worsening economic performance result from the 'exhaustion' of import substitution policies? Probably not. As argued elsewhere (Rodrik, 1999), the common timing of the downturns implicates the turbulence in the global economy after 1973, including the abandonment of the Bretton Woods system of fixed exchange rates, two major oil shocks, various other commodity booms and busts, and the U.S. Federal Reserve interest rate shock of the early 1980s. That some of South Asia's most ardent followers of import substitution policies—especially India and Pakistan—managed to maintain (Pakistan) or increase (India) growth after 1973 also suggests that mechanisms other than import substitution contributed to the economic collapse.[18]

Macroeconomic policies were among the most important of these other mechanisms. Many countries were unable to properly adjust macroeconomic policies in the wake of external shocks, leading to high or repressed inflation, scarce foreign exchange and large black market premiums for it, debt crises and external payment imbalances—greatly magnifying the real costs of the shocks. The countries that suffered the most were those with the largest increases in inflation and the highest black market premiums for foreign exchange. The culprits were poor monetary and fiscal policies and inadequate adjustments in exchange rate policies, sometimes aggravated by short-sighted policies of creditors and the Bretton Woods institutions (the World Bank and the International Monetary Fund). The bottom line for countries that experienced debt crises: the crises were the product of monetary and fiscal policies that were incompatible with sustainable external balances. Trade and industrial policies had little to do with them.

Outward-oriented industrialization

The East Asian 'tiger' economies are often presented as examples of export-led growth, where opening to the world economy unleashed powerful industrial diversification and technological advancement. But this conventional account overlooks the active role played by the governments of the Republic of Korea and Taiwan, province of China (and Japan before them) in shaping the allocation of resources. Neither economy undertook significant import liberalization early in the growth process. Most of their trade liberalization occurred in the 1980s, after high growth was already firmly established.

Key to the success of these and other East Asian economies was a coherent strategy of raising the returns to private investment through a range of policies that included credit subsidies, tax incentives, education promotion, establishment of public enterprises, export inducements, duty-free access to inputs and capital goods and government coordination of investment plans. In the Republic of Korea the main investment subsidy was the extension of credit to large business groups at negative real interest rates. Banks were nationalized after the military coup of 1961, giving the government exclusive control over the allocation of investible funds in the economy. Investment was also subsidized through the socialization of investment risk in selected sectors. This approach emerged because the government implicitly guaranteed that the state would bail out entrepreneurs investing in 'desirable' activities if circumstances later threatened the profitability of those investments. In Taiwan, province of China investment subsidies took the form of tax incentives.

In both Korea and Taiwan public enterprises played important roles in enhancing the profitability of private investment by ensuring that key inputs were available for private producers. Public enterprises accounted for a large share of manufacturing output and investment in both economies, and their importance increased during the critical take-off years of the 1960s. Singapore also heavily subsidized investment, but it differed from Korea and Taiwan in that its investment incentives focused on foreign investors.

Although trade policies that spurred exports were part of the arsenal of incentives in all the East Asian tiger economies, investment and its promotion were the primary goals. To that end, the governments of Korea and Taiwan resorted to unorthodox strategies: they protected domestic markets to raise profits, provided generous export subsidies, encouraged firms to reverse engineer foreign-patented products and imposed requirements on foreign investors (when they were allowed in) such as export-import balance requirements and domestic content requirements. All these strategies are now severely restricted under WTO agreements.

Two-track strategy

Relatively minimal reforms in China in the late 1970s set the stage for phenomenal economic performance that has been the envy of every developing country since. Initial reforms were fairly simple: loosening the communal farming system and allowing farmers to sell their crops in free markets once they had fulfilled their obligations to the state. Subsequent reforms created township and village enterprises, extended the 'market track' to the urban and industrial sectors, and created special economic zones to attract foreign investment. What stands out about these reforms is that they are based on two tracks (state and market), gradualism and experimentation.

Chinese-style gradualism can be interpreted in two ways. One perspective, represented forcefully by Sachs and Woo (2000), minimizes the relevance of China's particularism by arguing that its economic success is not due to any special aspects of its transition to a market economy, but largely to convergence between Chinese institutions and those in non-socialist economies. In this view the faster is the convergence, the better are the outcomes: 'favorable outcomes have emerged not because of gradualism, but *despite* gradualism' (Sachs and Woo, 2000, p. 3). The policy message is that countries looking to China for lessons should focus not on institutional experimentation but on harmonizing their institutions with those abroad.

The alternative perspective, perhaps best developed by Yingi Qian and Gerard Roland, is that the peculiarities of the Chinese model represent responses to specific political and informational problems for which there is no universal solution. Lau, Qian and Roland (1997) interpret the two-track approach to liberalization as a way of implementing Pareto-efficient reforms: an alteration in the planned economy that improves incentives at the margin, enhances efficiency in resource allocation and yet leaves none of the plan beneficiaries worse off. Qian, Roland and Xu (1999) see Chinese-style decentralization as a way of allowing the development of superior institutions for coordination: when economic activity requires products with matched attributes, local experimentation is a more effective way of processing and using local knowledge. These analysts find much to praise in the Chinese model because they believe that the system generates the right incentives for developing the knowledge required to build and sustain a market economy. Thus they are not overly bothered by some of the economic inefficiencies that may be generated along the way.

A less-known example of a successful two-track strategy is Mauritius, where superior economic performance has been built on a unique combination of orthodox and heterodox strategies. During the 1970s an export processing zone, operating under free trade principles, enabled a boom in garment exports to European markets and an accompanying boom in investment at home. Yet the export processing zone was combined with a domestic sector that was highly protected until the mid-1980s. In the early 1990s the International Monetary Fund still considered Mauritius the world's most 'policy restrictive' economy, and even by the late 1990s viewed it as one of the world's most protected economies (Subramanian, 2001). Mauritius has followed a two-track strategy not unlike China's, but underpinned by social and political arrangements that encourage participation, representation and coalition building.

The circumstances under which the Mauritian export processing zone was set up in 1970 are instructive, highlighting how participatory political systems help develop creative strategies for building locally adapted institutions. Given the small home market, it was evident that Mauritius would benefit from an outward-oriented strategy. But as in other developing countries, policy-makers had to contend with import-substituting industrialists who had been propped up by the restrictive commercial policies of the early 1960s—and who were naturally opposed to relaxing the trade regime.

A traditional World Bank or International Monetary Fund economist would have advocated across-the-board liberalization, without regard to what that might do to the island's precarious ethnic and political balance. The export processing zone provided a neat way around the political difficulties. The zone created trade and employment opportunities without removing protection from import-substituting industries and from the male workers who dominated established industries. The new employment and profit opportunities paved the way for more substantial liberalizations in the mid-1980s and 1990s. By the 1990s the female-male earning ratio was higher in the export processing zone than in the rest of the economy (ILO, 2001). Able to devise a strategy that was unorthodox but effective, Mauritius found its own path to economic and human development.

Key messages

Trade should be seen as a means to development rather than an end. Though there is a two-way relationship between trade and human development, trade theories do not offer unequivocal conclusions about the direction or dynamics of the relationship. Moreover, trade liberalization policies should not be viewed as a reliable mechanism for generating self-sustaining growth and reducing poverty, let alone achieving other positive human development outcomes.

Gender inequalities, an important but often neglected aspect of human development, mediate the relationship between trade policies and trade performance. Because of pervasive gender discrimination in economic life, men and women are generally affected by trade policies differently. Gender inequalities sometimes constrain countries' ability to increase exports—but they can also be used as an instrument of international competition. That is troublesome from a human development perspective because it can mean that export growth comes at the expense of gender equality, child care and family well-being.

The only systematic relationship between countries' average tariffs and nontariff restrictions and their subsequent economic growth is that countries dismantle trade restrictions as they get richer. With few exceptions, today's rich countries embarked on modern economic growth behind protective trade barriers but now have low barriers. The experiences of industrial and successful developing countries also provide two other lessons. First, economic integration with the world economy is an outcome of growth and development, not a prerequisite. Second, institutional innovations—many of them unorthodox and requiring considerable domestic policy space and flexibility—have been crucial for successful development strategies and outcomes.

The design of the multilateral trade regime needs to shift from one based on a market access perspective to one based on a human development perspective. It should also be evaluated not on the basis of whether it maximizes the flow of goods and services but on whether trade arrangements—current and proposed—maximize possibilities for human development, especially in developing countries. A world trade regime friendly to human development would provide domestic policy space and give developing countries flexibility to make institutional and other innovations. Such policy space should take precedence over market access considerations, even as the trade regime continues to recognize that market access can make an important contribution to human development in specific situations and for specific sectors and issues.

NOTES

1. During 1980–2000 average GDP growth was highest in East Asia and the Pacific (7.3 per cent a year), followed by South Asia (5.5 per cent), Latin America and the Caribbean (2.5 per cent) and Africa (2.2 per cent). This pattern was mirrored in the regions' export growth, which was 11.1 per cent, 7.9 per cent, 6.9 per cent and 2.8 per cent, respectively (World Bank, 2002).

2. The human development index is based on four indicators: life expectancy at birth, to reflect the dimension of a long and healthy life; the adult literacy rate and combined enrolment rate at the primary, secondary and tertiary levels, to represent the knowledge dimension; and real GDP per capita—measured using purchasing power parity (PPP)—to proxy for the resources required for a decent standard of living.

3. First, the human development index is not a comprehensive measure of human development: it ignores several important dimensions. Second, the index is composed of long-term human development indicators and does not reflect policy inputs or short-term human development achievements. Third, it is an average measure and so masks disparities and inequalities within countries. Disaggregating the index in terms of gender, region, race and ethnicity gives human development accounting much-needed breadth.

4. Gender refers to the social meanings constructed around sex differences; gender relations refer to the social norms and practices that regulate the relationships between men and women in a given society at a given time. Gender relations are not immutable; they change over time and vary across societies.

5. For example, formal credit institutions discriminate against women even though they are more reliable borrowers.

6. For economic analysis to be accurate and complete, unpaid work needs to be made visible and the economic meaning of work redefined to include unpaid household labour. For example, what may appear to be efficient from a market-focused perspective may be socially inefficient once full labour accounting and time use are considered.

7. Research in rural Tanzania found that even men in the poorest households forbid their wives from taking up wage labour (cited in Kabeer, 1996).

8. This discussion is drawn from Rodrik (2001).

9. The 'enlightened' standard view of development policy argues that to succeed, economic openness in developing countries requires both market access in advanced industrial countries and institutional reforms at home—ranging from legal and administrative reforms to safety nets. This view is 'enlightened' because it recognizes that there is more to economic integration than lowering tariffs and non-tariff barriers to trade, and standard because it represents the prevailing conventional wisdom (see World Bank and IMF, 2000).

10. The same is true of the promotion and subsidization of inward foreign direct investment (see Hanson, 2001).

11. This section and the next one are modified versions of the discussion in Çağatay (2001).

12. See UNCTAD (2002b) for a discussion of the fallacy of composition in global trade of labour-intensive manufactures.

13. This section is a modified version of the discussion in Rodrik (2001).

14. The supposition that one set of institutional arrangements must dominate has produced the fads of various decades. Europe, with its low unemployment, high growth and thriving culture, was the continent to emulate throughout much of the 1970s. During the trade-conscious 1980s Japan became the exemplar of choice. And the 1990s were the decade of US-style freewheeling capitalism.

15. The six countries were Swaziland, Botswana, Côte d'Ivoire, Gabon and Togo, with Kenya ranking 21st.

16. Countries such as Brazil, the Dominican Republic and Ecuador in Latin America; Iran, Morocco and Tunisia in the Middle East; and Côte d'Ivoire and Kenya in Africa all experienced more rapid TFP growth than any of the East Asian countries in this early period (with the possible exception of Hong Kong, for which comparable data are not available). Mexico, Bolivia, Panama, Egypt, Algeria, Tanzania and Zaire experienced higher TFP growth than all but Taiwan (Province of China). Of course, not all countries that pursued import-substituting industrialization did well. In Argentina growth in total factor productivity averaged just 0.2 per cent a year in 1960–73.

17. For example, although Mexico and Taiwan (province of China) are commonly seen as following diametrically opposed development paths, Little, Scitovsky and Scott (1970, pp 174–90) show that long after introducing trade reforms, Taiwan had a higher average effective rate of protection in manufacturing and greater variations in effective rates of protection than did Mexico.

18. Although India gradually liberalized its trade regime after 1991, its performance began to improve in the early 1980s—a decade before those reforms went into effect.

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