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TRADE LIBERALIZATION: WINNERS AND LOSERS, SUCCESS AND FAILURES

IMPLICATIONS FOR SMEs

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Abstract

Despite the long tradition in economics of trade being seen as net welfare-improving, criticisms of trade and hence of trade liberalization policies have been persistent, and perhaps growing over time, especially as far as LDCs are concerned. Modern empirical research has shown some of these concerns to have been overblown and that the import substitution (ISI) policies employed by most LDCs seemed to be leading to a dead end. As a result, many LDCs adopted trade and other reforms beginning in the mid-1980s. By the early 1990s, the sentiment for trade liberalization and other reforms was so widespread and dominant that a "Washington Consensus" was declared. Despite high expectations, even the more recent experience with trade liberalization has had very mixed effects.

The paper is organized as follows: Section 1 identifies types of trade liberalization policies and provides examples of each. Section 2 summarizes the experience. This turns out to have been much more mixed than was expected both on the basis of theory and that early experience of the East Asian miracle. Trade liberalization goes through three stages. Six different obstacles to trade liberalization are identified: (1) obstacles to market access by new and small firms (SMEs), (2) inability of the government to commit credibly to program creation and implementation, (3) obstacles created by the resistance of the owners of asset-specific capital, (4) inadequate or inappropriate legal, regulatory and juridical institutions, (5) fears that the government lacks the political, financial, or technical will or ability to limit the likely negative externalities arising from trade liberalization, and (6) transitional rigidities or lack of cooperation between different groups that act as a barrier to efficient responses by the private sector. Some of these obstacles are relevant in the pre-reform stage, others in the reform implementation stage and still others in the post reform period. In the latter case, the benefits may be less than expected or "promised" and may be accompanied by unwanted and unexpected costs. These categories and the lessons of experience are drawn upon in subsequent presentations at the Forum.

Trade Liberalization: Winners and Losers, Success and Failures
Implications for SMEs*

Jeffrey Nugent

Most of the countries of the Third World (LDCs) became independent between 1950 and 1970 and, as a result of concerns for market failures, chose an import substituting industrialization (ISI) trade strategy. Yet, by the early 1980s, LDCs had come to realize that state failures were at least as common as market failures and that the state was not a reliable substitute for well-functioning markets. All the world took in the East Asian Miracle, wherein a group of heretofore very poor (even "basket case") economies managed to break out of the their ISI orientations and indeed succeed in exports on a rather massive scale. Indeed, such countries as Taiwan, Korea and to a lesser extent several other countries of Asia, have become star performers in growth, without increasing their already relatively low degree of income inequality.

Beginning in the mid-1980s and continuing to the present, other LDCs have gradually chosen to follow the lead of Taiwan and Korea in transforming their policy orientations through policies of trade liberalization. To date at least, the theoretical rationale for trade liberalization remains extremely strong.[1] In particular, trade liberalization is believed to yield both static and dynamic benefits. Among the former are the ability of the country (1) to make better use of the resources in which it is well endowed, (2) to emphasize those sectors in which it can produce more efficiently than other countries, (3) to increase competition and thereby reduce the losses associated with monopoly (the manufacturing sectors of many LDCs being dominated by one or a few different large (often foreign) producers, and (4) to decrease the scope for corruption and thereby allow time and resources to be spent more on productive rather than rent-seeking activities. Among the latter are (1) the dynamic effects of competition on technological change, (2) the effects of increased trade flows on domestic and foreign investment, (3) the effects of the agents that trade on the supply of international market information and the demand for other market friendly institutions

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[1] Indeed, this rationale goes back to the origins of the economics discipline. Classic works include Smith 1776, Ricardo 1820, and Mill 1902, and more recent ones Hechscher (1949), Ohlin (1933) and Leamer (1984).

and policies, (4) the inequality-reducing effects derived from the factor price equalization[2] effect of trade, and (5) the effects of foreign investment on technology change and its spread among domestic firms including small and medium enterprises (SMEs).

Despite the long tradition in economics of trade being seen as net welfare-improving, criticisms of trade and hence of trade liberalization policies have also been remarkably persistent and perhaps even growing, especially as far as LDCs are concerned. Among the early concerns of trade liberalization from the LDC perspective were fears of terms of trade deterioration for primary exporters, the harmful effect of dependence on allegedly endemically unstable exports, unbalanced political and economic power that tilt the enforcement and practice of liberalized trade rules in favor of rich countries, and that the benefits of international trade in LDCs might accrue largely to large multinational companies (MNCs).[3] Yet, modern empirical research has shown most of these concerns to have been vastly overblown and that the ISI policies employed by most LDCs seemed to be leading to a dead end,[4] explaining why so many LDCs adopted trade and other reforms beginning in the mid-1980s. What gave the reforms an additional push in the late 1980's was the fact that at this point many LDCs were in serious debt crises, making them unusually susceptible to the trade liberalization policy advice coming from international donor organizations, especially the World Bank and International Monetary Fund. By the early 1990s, the sentiment for trade liberalization and other reforms was so widespread and dominant that a "Washington Consensus" in which such reforms were featured was declared.

The remainder of the paper is organized as follows: Section 1 which follows identifies different types of trade liberalization and provides examples of each. Section 2 summarizes the experience. This turns out to have been much more mixed than was expected both on the basis of conventional theory and that early experience of the East Asian miracle. In short, (1) fewer countries have undertaken trade reforms than might have been expected; (2) those that have undertaken trade liberalization have done so only tentatively or even discontinued the reforms before they were fully implemented; and (3) in many cases countries that have liberalized trade have realized less than expected in terms of benefits and more than expected in terms of costs.

[2] The standard explanation of this effect is that, since LDCs are well endowed in labor relative to capital, trade liberalization should allow them to expand their production of labor-intensive products and decrease that of capital-intensive products, thereby causing wage rates to rise. This idea derives from Stolper and Samuelson (1941)
[3] See especially Prebisch 1949, 1950, Singer 1950
[4] See especially Yotopoulos and Nugent (1976) and Krueger (1978)

Section 3 asks why more countries have not undertaken reforms; Section 4 asks why the reforms undertaken have often been tentative or discontinued; and Section 5 asks why the countries that have gone quite far in implementing trade reforms have had fewer benefits and more unwanted effects. Section 6 concludes.

1. What Is Trade Liberalization?

Well over 60 LDCs received loans from the World Bank during the 1980s and 1990s for purposes of trade liberalization and some others countries have approached trade liberalization without World Bank support. As part of their commitments to regional trading arrangements such as NAFTA, the EU and APEC and the Uruguay round of multilateral trade negotiations under the WTO, many developed countries also engaged in considerable trade liberalization without support from the international agencies. Clearly, social, political and economic circumstances differed greatly among these countries so that it was neither practical nor desirable that trade liberalization should take the same form or follow the same sequence in every country. Indeed, a wide variety of specific reforms have been undertaken under the mantle of trade liberalization. In some cases, moreover, such reforms have included macroeconomic stabilization policies, tax reform, liberalization of international capital flows, legal reforms, educational reforms and administrative and political reforms, and the clarification and enforcement of property rights that also constitute components of the aforementioned "Washington Consensus". Nevertheless, with the possible exception of stabilization, most analysts have suggested that it is usually on the trade liberalization front that the most progress has been made.[5]

Broadly speaking, two quite distinct paths to or strategies for achieving trade liberalization have been followed. The first and perhaps dominant one of these is the "getting the prices right" approach. This approach seems to have been favored by the World Bank. It encompasses the following specific actions (1) removing exchange rate distortions via devaluation or the floating of the exchange rate and exchange rate unification, (2) removing non-tariff barriers to imports and replacing them by tariffs (if at all), (3) homogenizing tariff rates into several categories with smaller

[5] For example, Corbo (2000) cited various indexes of reform and liberalization for Latin America as a whole in which for the decade 1985-95 Latin America received a score of 80 percent for trade liberalization, 57 percent for financial liberalization, 28 percent for tax reform, 27percent for privatization, and labor market liberalization 3 percent.

spreads between them, (4) freeing imports from licensing requirements to increase competition in product markets, (5) privatizing foreign trade (in those cases in which such trade had been monopolized by the public sector), (6) eliminating export taxes, and (7) joining the World Trade Organization (WTO)[6].

The other trade liberalization strategy is a more partial one, presumably used when the more complete "getting the prices right" one is deemed politically infeasible or otherwise unacceptable. This approach has taken two forms: (1) retaining relatively high rates of protective tariffs but offsetting their negative effect on exports with an import duty drawback system and/or export subsidies (usually through subsidized credit on exports), and (2) Export Processing Zones (EPZs). In some cases, the two strategies have been used sequentially or even simultaneously. This is because, even at its most ambitious, trade liberalization through getting the prices right has been only partial, implying that in fact both approaches are only partial and that the two strategies may be complementary. Since activities inside EPZs are not subject to the normal protective regime and in some cases other regulations, in some respects EPZs remove constraints that are well beyond those liberalized in the "getting the prices right" approach.

Outside of East Asia, early countries to liberalize trade were Chile in the late 1970s, Turkey beginning in 1980, Morocco and Spain beginning in 1983, and Australia, Bolivia, Indonesia, Mexico and New Zealand by the mid-1980s. Not surprisingly, the earliest members of the Central and East European bloc to reform (Poland Czech Republic, Hungary, Estonia) began their trade liberalizations only after 1989. Many other countries from Asia and Latin America liberalized only at the end of the 1980s and during the 1990s. But, still other LDCs have yet to make much progress in trade liberalization (especially in the Sub-Sahara Africa (SSA) and Middle East and North Africa (MENA) regions).

Different countries have paced their reforms very differently. Chile's trade liberalization measures were especially strong and rapid. Between 1973 and 1979, NTBs were eliminated and all tariffs reduced from rates ranging up to 500 percent in 1973 to 10 percent in 1979 (although they were temporarily raised to 35 percent during the macroeconomic crisis of the early 1980s). It should be noted that Chile's action was taken under a military government with some Chicago School

[6] Accession to the WTO requires a country to commit to a package of reforms jointly agreed to by the country and the WTO membership. Getting to this stage involves full disclosure of information and making the decision processes in trade policy and rule enforcement fully transparent.

economist-technocrats in charge of economic policy. Its leaders had a remarkable agreement on economic fundamentals and believed that radical and rapid reform was the way to implement it so as take people by surprise and prevent opposition to trade liberalization from building up (Pinera 1994).

The case of Spain was much more gradual and came in several important steps, actually beginning under Franco in 1959, and then again in 1970. The third round of trade liberalization (that began in 1983 under the Socialists) was carried out rather slowly and only after the formation of a strong political consensus and a pact between the government and labor and other groups (de la Dehesa 1994). The achievement of this consensus was facilitated by popular opinion favorable to joining the European Union and the increased openness that this required. This path was also facilitated by the fact that the transition was accompanied by substantial foreign investments in manufacturing and almost unprecedented sustained relatively high rate of economic growth. Turkey's pace of trade liberalization was also rather slow and gradual Very gradual devaluation followed by tariffication of NTBs and subsequently tariff rates were features of Turkish trade liberalization. Exporters were also allowed to import their raw materials and intermediate goods at world prices and assisted by credit and insurance from and Export-Import Bank (Canevi 1994).

The composition of the "getting the prices right" varied greatly across countries as well as over time. For example, Spain's earliest rounds of trade liberalization featured devaluation and exchange rate unification whereas later ones featured elimination of NTBs and tariff reductions. Privatization of trading firms was a common characteristic of trade liberalization in the countries of the former socialist bloc. In several of the Latin American countries late to liberalize trade, such as Argentina and Brazil, much of the trade liberalization occurred as a result of joining MERCOSUR.

Naturally, each different approach has advantages and disadvantages relative to other trade liberalization strategies. Of special relevance and importance are the advantages and disadvantages of the partial or "second best" approaches vis-à-vis those of the "getting the prices right" approach.

Duty Drawback Systems

Duty drawback systems are especially advantageous in countries with highly protection trade regimes with little prospect for eliminating or even reducing this protection in the short run. Several features of highly protective regimes, e.g., high rates of effective protection, tariffs on intermediate inputs (regardless of whether these inputs are imported or domestically produced), anti-dumping duties and NTBs, combine to produce a substantial anti-export bias. That bias arises from the fact that the costs of production are raised by such measures whereas the export price can be no higher than that on the world market (without such a price boost). Providing drawbacks on duties paid for imported inputs helps reduce the anti export bias but does not eliminate it because (1) there are often substantial delays and administrative costs to the firms in obtaining the drawbacks, (2) the drawbacks don't apply if in fact the goods are domestically produced behind the import barriers, and (3) the drawbacks do not compensate for higher prices resulting from NTBs and monopolistic pricing by the owners of import licenses. Another longer run shortcoming of duty-drawback systems is that their presence lowers the lobbying pressure of exporters to decrease protection on imported intermediates. In other words, the presence of this "second best" trade liberalization mechanism may contribute to stagnation of the process.

To be acceptable to an LDC exporter, the duty drawback system must work efficiently and without failure or breakdown. This is because the exporter must be assured that he will get reimbursed for the duties paid on imported inputs. But for this to be the case, the government, must have an efficient and honest customs service, a solid statistical information system, an incentive system to make sure that the reimbursements are timely, and be on a sufficiently solid financial footing that there will be reimbursement delays caused by a lack of funds and foreign exchange.

A duty drawback system would also have to be acceptable to the government. Yet, such systems may not be attractive to LDC governments because of either anticipated losses in government revenue (since tariffs are typically a major source of total government revenue in LDCs) or fears that the drawback provisions will provide an incentive to cheat on or abuse the rules for qualifying for drawbacks, increasing vulnerability to corruption.

Given the advantages and disadvantages of duty drawbacks, what is the experience? Their use is indeed common. Cadot, de Melo and Olarreaga (2000) found that 39 of the 42 countries that had gone through WTO trade policy reviews had some form of duty drawbacks in place. Among countries that are still in the early stages of trade liberalization, their use may be even more prevalent.

Export Processing Zones (EPZs)

As noted above, EPZs are another second-best or partial means of trade liberalization. In this case, the special regime to offset the anti-export bias is a geographic one. Typically, an EPZ is a rather limited geographic area in the country, perhaps merely a small area near a seaport or a border crossing to another country. In the EPZ, imports of not only intermediate inputs but also capital goods are allowed to enter free of duty (thereby avoiding the need for a rebate system) but these imports cannot be shipped out of the EPZ itself except as inputs into exports. Activities in these zones may also be free of (or less constrained by) other regulations such as those against hiring foreign workers and managers and/or those relating to foreign ownership, financing, social security taxes, corporation and other taxes, labor laws, and cumbersome registration requirements. In this sense, EPZs can go beyond not only duty drawback schemes but also other, more "complete" forms of trade liberalization.

Again, EPZs have advantages and disadvantages. Like duty drawback systems, their use by a country allows exports, foreign exchange earnings and manufactured goods production and employment to expand without having to demolish an already established system protection of ISI. To be successful, EPZs need adequate infrastructural investments but by focusing those investments on EPZs, total infrastructure costs for success in exports can be reduced. Similarly, by concentrating the supply of high quality transport, energy, telecommunications and customs services on EPZ, the need of upgrading these whole systems in the country as a whole can be avoided. EPZs can also serve as a means of attracting FDI and thereby of encouraging technology transfer to local workers, managers and firms. But, usually because of restrictions on sale of EPZ production to the domestic market and on purchases of goods and services from outside the EPZs, linkages with the rest of the economy are often very small or even non-existent.

2. What Has Been the Experience with Trade Liberalization?

The remarkable success of East Asian countries, especially Korea and Taiwan with their trade liberalization programs is too well known to justify retelling. As indicated above, these countries combined virtually all means of trade liberalization. In their early phases they relied on duty drawbacks, then EPZs, then tariffication of NTBs and finally tariff reductions. Throughout the liberalization episodes, exchange rates were adjusted so as to maintain stable real exchange rates and assure the profitability of exports. Both countries were relatively interventionist until fairly recently, but they did liberalize trade. This experience has been given great credit for moving other countries to question the wisdom of remaining on their import substituting trade regimes. The fact that they succeeded in manufactures export growth sustaining growth rates of some 10-15 percent per annum in exports over several decades without increasing income inequality measurably was especially impressive.

In both cases, the countries started at a very low level and with little except agricultural products to export. Both became major exporters of increasingly sophisticated manufactured goods. Both countries had to overcome international marketing problems. In Taiwan's case much of the development and exports came from SMEs. SMEs overcame their marketing problems by taking advantage of a fairly tight network of overseas Chinese. In Korea's case, the share of SMEs was very high prior to liberalization, fell substantially with liberalization until the mid-1970s and then rose again after this at least until the mid 1990s. In both countries, strong networks of subcontracting relationships developed to link SMEs with large enterprises. Over time, and partly supported by SME support programs, the SME share in exports rose even in the case of Korea.

Chile and Mexico

As mentioned above, Chile was one of the first countries outside of East Asia to liberalize its trade. For this reason, the Chilean experience has been closely followed. Chile's trade liberalization was especially radical in its speed and emphasis on the "first-best" policies of removal of NTBs, tariff reduction and homogenization. The tariff reduction was strategically counterbalanced by real exchange rate depreciation. Chile also used duty drawbacks somewhat in the first phase and direct subsidies for fishing and tree planting, two sectors deemed to be candidates for export expansion. By about 1980 Chile already had the lowest tariffs in Latin America and it has maintained that position ever since. Yet, the process has not always been smooth and the effects have been quite mixed. Indeed, in the early 1980s, capital inflows caused the exchange rate to appreciate. Also, the sharp decline in tariff revenue combined with recession to increase the government deficit very sharply. External debt grew rapidly forcing Chile to temporarily reverse course by imposing import surcharges until the mid-1980s after which the country returned to trade liberalization.

According to Edwards and Lederman (1998) some of the effects of trade liberalization are reported to have been positive. In particular, exports were diversified away from copper and other minerals and increased rapidly, and aggregate efficiency - measured by total factor productivity – increased.

Unlike the East Asian countries that exported labor intensive goods, Chile was and remains an exporter of natural resource-intensive goods, originally mostly minerals, and later supplemented by fish, forest products and agricultural products (mostly fruit and wine). Hence, this may explain why the effects of trade liberalization on factor prices were rather different than in East Asia, indeed lowering wages relative to land and other rents, and thereby increasing income inequality.

In fact, Marcel and Solimano (1994) showed the increase in income inequality during the trade-liberalizing Pinochet years to have been very substantial, mainly a substantial decline in the income share of the middle class and a large increase in the income share of the top 20 percent of income earners. Both Berry (1998) and Riveros (1998) carefully compare the available estimates for greater Santiago over time and find that the poorer 40 percent also lost significant shares during both the initial and subsequent liberalizing phases. The unemployment rate rose from 4.8 percent just before liberalization to 13.6 percent during the first liberalization and 23 percent the subsequent the recession which triggered the temporary reversal of liberalization. The percentage of people living in poverty increased at least during the first ten years of the liberalization (perhaps from 17 percent in 1970 to as high as 45 percent in 1985 (after which it has declined)). Naturally, since many policy changes were taking place simultaneously, it is difficult to separate the trade liberalization effects from others[7], especially with only aggregate data. To overcome this problem, Edwards and Edwards (1997) used micro-level data for some of the key years in the first big wave of trade liberalization (1973-79) to show that both the probability of unemployment and the duration of unemployment among workers were positively related to the degree of liberalization.

Although rather anecdotal in nature, there is also some evidence of environmental damage caused by Chile's radical trade liberalization in the absence of more substantial environmental protection efforts in the early phases of the reforms. Among these were health effects resulting from heavy use of insecticides in the fruit tree growing areas, over-fishing, and deforestation (Green, 1995). Soil erosion and desertification also increased simultaneous with the trade-induced changes in land use. The amounts of air and water pollution arising from Chile's mining industry were also large and rather serious. Appropriate regulatory mechanisms, however, are only now being developed (United Nations Environmental Program 2002).

Naturally, the environmental effects of trade liberalization on human health are often rather indirect. One means of assessing such impacts is through the use of simulations based on detailed computable general equilibrium models showing the impacts of different activities on each of

[7] Privatization of state enterprises, suppression of some labor unions, and the curtailment of agricultural credit to small farmers, e.g., were other policies which could also have been expected to increase income inequality.

several different pollutants, each with differing impacts on human health. One recent study of this sort for Chile (Beghin, Bowland, Dessus, Roland-Holst and van der Mensbrugghe, 2002) shows that the results are very sensitive to the type of trade liberalization. While Chile's accession to NAFTA was deemed not to increase pollution and therefore to worsen health, deeper integration with MERCOSUR and unilateral liberalization to the world as a whole was estimated to increase pollution and thereby hurt health in Chile. This suggests the need for environmental protection measures to be developed hand-in-hand with trade liberalization strategies. The means by which such results are realized (as stated elsewhere) is that the more trade tilts production toward heavy manufacturing, smelting and energy-using sectors, the more environmental harm that may occur (Antweiler, Copeland and Taylor 2001).

As noted above, Mexico's trade liberalization program also included tariff reductions and real exchange rate depreciation as in the case of Chile. Yet, it also relied very heavily on the maquila industry, a variant on both the EPZ and duty drawback systems, in which heavy reliance is placed on imported inputs and built-in exports to the United States but also low linkages to the rest of the economy. Maquila or customs-bonded plants can exist outside of EPZs and in the case of Mexico are located at or near its long border with the US. Berry's (1998) survey of inequality evidence in Mexico reveals a fairly sharp increase in overall income inequality, and perhaps more surprisingly a sharp increase in wage inequality from 1984 to 1992 (Alarcon and McKinley, 1998) but unemployment rates never approached the levels that had been reached in Chile. The importance of the maquila component of Mexico's (and also Central America's) trade liberalization could help explain why unemployment there was never as high as in Chile. The substantial inflows of FDI in Mexico and to a lesser extent Costa Rica, only some of which were related to the trade liberalization, make it difficult to disentangle the FDI effects on inequality from those of trade liberalization. In the case of Mexico, much of this FDI was in relatively capital intensive industries, leading some analysts to conclude that the type of trade pattern that emerged in Mexico did not fit Mexico's factor proportions, namely its heavy endowment of unskilled labor relative to capital and skilled labor.[8]

[8] As Alarcon and McKinley (1998) put it, "Mexico's policy of trade liberalization…has in fact led to a distorted process of economic restructuring and a pattern of trade specialization that does not reflect the country's endowment of abundant labor. Most of the growth of manufactured exports in the 1980s was the result of intra-firm or intra-industry trade in a few sectors already highly internationalized, rather than any broad-based reorientation of domestic producers toward exporting."

Deleterious environmental effects of trade liberalization are also in evidence in Mexico, especially along the country's northern border. This can be attributed to the fact that the northern border was not well endowed with the kind of infrastructure for dealing with these problems. Water is extremely scarce, toxic waste disposal was non-existent, systems for monitoring pollution were not in place and enforcement was weak. Indeed, concerns for this from the U.S. side of the border were sufficiently strong as to hold up the signing of NAFTA until it was accompanied by an environmental protocol. Nevertheless, the Mexican government's commitment in this protocol to monitor pollution and enforce rules was judged by many as not credible.

More recent data on income distribution data for Chile and Mexico in the mid to late 1990s reveals a leveling off in the deterioration or possibly even some improvement in both poverty and inequality in this period, though even this may still be controversial. The increasing availability of data on both income distribution and indexes of trade and other forms of liberalization now make it possible to use data from different countries over time to trace out the distributional effects of different reforms. Morley (2000) did this and found that, in contrast to most of the preceding studies, trade liberalization index had a small (and not statistically significant) positive effect in the degree of income inequality.[9]

There is another aspect of the experience of Chile and Mexico that is disturbing as far as the income distribution effects of trade liberalization are concerned. This was due to the fact that the trade reforms were carried out simultaneously with strong measures to trim the public sector, including social protection programs. Hence, social protection against adverse employment was reduced sharply, explaining in part why the upward spikes in income inequality that occurred during these countries' trade liberalizations were the sharpest of any countries reviewed. Even more serious is that the upward spikes have never been reversed with the eventual end of the recessions that some of the reforms ushered in (Morley 2002).

Since Chile and to a lesser extent Mexico were countries that emphasized the traditional "complete" or "first-best" approach to trade liberalization, let us focus more specifically on experience with the "second-best" or partial approaches via duty drawbacks and EPZs.

Experience with Duty Drawbacks

[9] Such results are also sensitive to slight changes in the specification. For example using similar data, Behrman, Birdsall and Szekely (2001) showed that, when the reform indexes were lagged four years, their impact on inequality was negative (but again not significant in the statistical sense).

First, with respect to duty drawbacks, it can generally be said the experience has not been very favorable. Few countries have had the information systems, high quality and honest customs bureaucracies, incentive systems and sufficiently strong financial bases to allow these systems to work efficiently, rapidly and reliably. As a result, potential exporters have usually not deemed the promises of rapid reimbursement credible and hence have not been inclined to make major investments in production for export on that promise.

There have however, been some exceptions. Three early exceptions were Japan, Korea and Taiwan. Each of these countries was during the initial phases of trade liberalization intent on promoting exports without reducing tariffs and NTBs and hence without reducing the protection offered for domestic manufacturing. Although the details of their programs varied somewhat, they all worked well, especially in comparison to the many failed experiences of other countries.

From 1955 into the early 1980s Taiwan put great emphasis on duty drawbacks in its drive to raise exports. According to Wade (1988), the system worked as follows: An exporter with actual or anticipated use of imported inputs would apply to have his product and a certain imported input per unit of output approved for the program. Customs officials were authorized to seek consultants and make plant inspections to check the veracity of the amount specified in the application. They were required to reply to the application within one month. The customs officials were well paid, well trained, had high esprit de corps and faced penalties if they failed to meet the deadline. To reduce the bureaucratic steps and the time for the exporter to get reimbursed, the importing exporter paid for the import duties with a postdated check that would be returned to the exporter if proof that the export sale was consummated could be made within the specified period of time (the date on the check). Otherwise, the check would be cashed, implying that the exporter would not be reimbursed. For a time, the customs officials were to periodically check on the use of the pre-specified imported inputs but, after a successful track record relating the amounts of imported inputs to export sales had been established, further checking was deemed unnecessary. To reduce the transaction costs of operating the scheme, only cases in which imported inputs constituted at least 1 percent of the value of exports were eligible for the program.

Thomas, Nash et al. (1991) describe the way the Korean system worked. Considering that duty drawbacks do not fully remove the anti-export bias, between 1965 and1980 (like Japan and Taiwan earlier) Korea was anxious to stimulate export growth without reducing its protection for import-substituting industries. What Korea did was to maintain a steady real exchange rate by continuously devaluating at a pace sufficient to maintain the profitability of exports in the face of the protectionist tariff regime. Not only this, but exporters were allowed to pay world prices for their imported inputs and to speed up customs procedures by applying a special customs regime for exporters and also to provide credit for working capital and fixed capital at subsidized rates. Once again, Korea's duty drawback scheme had the advantage of having a prestigious, well managed and honest bureaucracy to run the program. Only those firms which could show they were efficient and competitive by succeeding in export markets could benefit. In such hands, the promise of prompt and reliable duty reimbursement was credible to exporting firms. In both Korea and Taiwan, the protective regimes were gradually phased out and the commitments to do so were again credible, thereby not undermining the incentive for further import liberalization among actual or potential exporters.

While the experience with duty drawback systems in Latin America has included some relatively successful cases (Mexico, Colombia and Brazil in the late 1960s), overall it has been no better than elsewhere outside of the successful East Asian cases. Some recent experience in that region's Mercosur free trade area has demonstrated the importance of an important political economy effect. This is the effect that duty drawbacks can have on further liberalizing imports of intermediate imports. In particular, Cadot, de Melo and Olarreaga (2000) showed that when Mercosur decided to eliminate the drawback system on imports, domestic firms stepped up their lobbying efforts to reduce tariffs on other imported inputs, thereby contributing to the further spurt in trade liberalization in recent years. But this means that, as long as the duty drawback system remains in place, it discourages further trade liberalization.

Some Experience with EPZs

As with duty drawback systems, the experience with EPZs has also been very mixed. Even aside from low linkages, the benefits of EPZs are often well below those expected. In some cases, many of the benefits accrue largely to foreigners rather than to nationals of the country.[10] Because of unrestricted access to imported inputs, in reality, net exports are often only a small fraction of gross exports (e.g., 12 percent in Jamaica). Technology change is often limited and even employment

[10] al Khouri and Tovias (2002) show this to be largely true in the early stages at least for some of the new EPZs in Jordan known as Qualifying Industrial Zones (QIZs) that require cooperation among Jordan and Israel in production in return for free access to the U.S. market. Both employees and investors have been largely foreign though export growth from them has been extremely impressive.

growth is often modest.[11] But, there are also many successful cases, and some of these extremely successful, suggesting that the outcomes depend on many factors, such as ownership and management of the schemes, the nature of the regime itself, the quality and quantity of the local labor force, and the availability and quality of physical infrastructure.

One of the earliest and most successful cases was Mauritius. In that country, EPZ exports as a percent of total exports grew from 3 percent in 1971 to 52.8 percent in 1986 and 68.7 percent in 1994 (Madani 1999), in the process reducing the country's unemployment rate from over 15 percent to 1.4 percent.

What were some of the ingredients of its success? The EPZ law of 1971 exempted EPZ firms from excise taxes and duties on imported machinery, raw materials and intermediate goods, provided free repatriation of capital, profits and dividends, tax breaks on corporate profits and dividends, and a liberalized labor regime. At first, much of the investment was domestic in origin but subsequently by 1988, FDI accounted for 25 percent of EPZ investment and perhaps as much as 45 percent by 1994. One-half of the EPZ firms and over 80 percent of EPZ employment were concentrated in the garments sector. From the beginning infrastructure was excellent, the labor force well-educated, the country politically stable, leading firms to deem credible the country's commitments to the stability of the favorable EPZ regime. An especially successful feature was a gradual increase in backward linkages to the rest of the economy, accounting for a gradual increase in the ratio of net exports to total exports (to over 40 percent) and demonstration effects from EPZ activities to non-EPZ ones (Rhee, 1990). While in some of the other more successful EPZs, such as Dominican Republic, Panama and Tangiers, EPZ management has been private, that in Mauritius has been public, but with an incentive system to make it responsive to the needs of EPZ firms and with backup support and advice from the Chamber of Commerce. Firms do not need to deal with the myriad of different service suppliers since there is a single stop service.

The facts that Mauritius also benefited from a preferential trade agreement with the European Union and that its EPZ developed before there was much competition from other EPZs were other factors contributing to its success. Notably, the concessions to EPZ firms in Mauritius did not exempt these firms from labor union activity. Given the importance of union workers in the

[11] Senegal's EPZ located in the capital city of Dakar saw employment growth to 1200 between 1976 and 1986 but decline to 600 by 1990 with only ten firms exporting a meager amount in net terms.

electorate and the competitive nature of Mauritius' elections, this may have been strategic to the long-term public support for EPZs in the country.

Korea and Taiwan also had successful EPZs but these were developed somewhat after the initial surge in exports attributable in part to the drawback schemes described above. In these cases, the shares of net exports in total EPZ exports reached well over 60 percent. Some factors that make Mauritius, Korea and Taiwan most stand out from the many relative failures among EPZs are (1) that EPZs in the former were part of a consistent and strong package of export promotion and trade liberalization policies, and (2) that the EPZs aimed at specific markets, the EU in the case of Mauritius, and Japan and the US in the case of Korea and Taiwan.

While one trade liberalization instrument (s) can greatly reduce one or more problems faced in trade liberalization relative to others, even the very brief overview of the overall experience given above indicates important commonalities among the problems encountered in practice. These seem to be the following:

(1) The programs tend not to work as well as they are supposed to or are promised so even the potential beneficiaries do not benefit.

(2) The government budget balance may be adversely affected, especially after an adverse shock to the economy, bringing about increased external borrowing and threatening the trade liberalization with non-sustainability.[12]

(3) Unemployment rates and income inequality increased.[13]

(4) Since trade liberalization was often accompanied by stabilization programs and programs to limit the size of the public sector, the losers of trade liberalization were often left with little or nothing in the way of public or other safety nets.

(5) For the same reason the quality and quantity of public services like health care, education and public safety were also reduced, especially in recessions.

(6) The benefits of trade liberalization often leaked out primarily to foreigners, foreign investors and foreign traders.

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[12] In its internal evaluation of a sample of nine World Bank loan support programs for trade policy reforms, the World Bank (1992) identified Cote d'Ivoire, Ghana, Mexico, Morocco, and Turkey as countries in which tax revenues relative to GDP fell after the onset of the trade liberalization programs. As mentioned above, this was also true in a big way for Chile (not included in the World Bank sample. Two of these countries avoided serious trouble by increasing their non-tax revenues such as oil and privatization revenues.

[13] Of the 18 liberalizations studied by Thomas, Nash et al 1991, p.73, unemployment rates rose in ten of them. In these, the average increase was 3.8 percent. In the others the average decline was 0.9 percent.

(7) Even among domestic firms, the size structure of firms is often tilted toward the large firms and conglomerates that are better positioned to take advantage of the opportunities created by trade liberalization than smaller firms. So too, the linkages between foreign or large advantaged domestic firms and SMEs is very weak.

(8) Environmental effects can be quite substantial and harmful to human health.

With these problems as background, we turn now to the three questions set out in the introduction: (a) Why have so few countries liberalized trade?

(b) Why have the trade liberalization measures undertaken been so tentative and sometimes discontinued or even reversed?

(c)Why have the countries that have carried out trade liberalization had smaller benefits and greater unwanted costs than had been expected?

3. Pre-reform Obstacles: Why Have So Few Countries Liberalized Trade?

The basis for this first question is that outside of the East Asian and Latin American countries mentioned above, very few LDCs have undertaken any serious trade liberalization. For example, in South Asia, sub-Sahara Africa and the Middle East, there are few countries that have made much progress in trade liberalization. As a result, many of the countries of these regions and also some of those from the transition economies of Europe and Central Asia, Asia and Latin America are still characterized by pre-reform conditions such as misaligned exchange rates, exchange rate variability, NTBs, relatively high and variable tariff rates, and the absence of any comprehensive program to promote exports. For example, Table 1 shows that as recently as 1995-98, 58.3 percent of commodities are subject to NTBs in South Asia, the average black market premium (a measure of exchange rate misalignment) is 46.5 percent in the MENA region and 32 percent in the SSA region, the average tariff rate is still 32 percent in South Asia and 23 percent in MENA, the standard deviation of tariff rates is 23 in MENA, and between 33 and 47 percent of the countries in all four regions identified in the table still have restrictions on current account transactions.

In answering this and the other questions posed above, our objective is not to provide an encyclopedic list but rather to identify the key obstacles. As we shall show in subsequent papers in the forum, embedded in these obstacles are troublesome institutional problems. Inherent in the different questions posed is that the obstacles arise in different stages of the reform process. Those that arise in relation to the first question are ones that arise prior to reform. In the case of the other questions, however, the obstacles include ones that arise either in the process of implementing the reforms or in the post-reform responses stage.

The most important obstacle to undertaking the reform in the first place would appear to be the asymmetries in the relative strengths of the vested interests benefiting from and hurt by the pre-reform ISI regime (and consequently also of those who would lose from and benefit from liberalization away from that regime). The beneficiaries of ISI include firms and their workers protected by tariffs and quotas and, because of the high tariff dispersion that is usually present in such regimes, those who benefit from imports at the overvalued exchange rate with little or no tariffs. Given the small numbers of producers in each such industry and their largely urban location, these groups are typically strong, well organized and have good access to government officials. Government officials may also benefit from this situation as managers of state enterprises, or in sharing in the rents of the system. On the other hand, the potential beneficiaries of reform, such as potential exporters are not likely to be easily identifiable, since in many cases they might not yet be exporting or even producing at all.[14] Even if these potential beneficiaries are identifiable, e.g., the farmers who are discriminated against in the ISI regime, they are generally scattered, individually small, poorly educated and organized, and rather weak politically. The problem is compounded by the fact that many people may be uncertain as to whether or not they will benefit from reform, implying that they are unlikely to stand up for trade liberalization. Still another problem is that the benefits of liberalization take time to be realized, whereas the costs in terms of job displacement, possible bankruptcies for existing ISI firms would be sustained quickly.

Those countries that have had strong trade liberalization programs have clearly managed to overcome this obstacle by making a strong and credible commitment to reform. Typically, this has included a realistic pre-announced schedule for lowering the tariffs and NTBs, announcing and sticking with a very simple rule for how these new rates will be set (such as all being reduced at 10 percent per year, or collapsing all the tariff categories into two or three different ones), announced depreciation of the exchange rate (so as to offset the reduction in tariffs and NTBs, thereby undermining the opposition to reform from existing industries, duty drawbacks to allow existing producers (including SMEs) to get into exporting even before the tariff and NTB cuts are

[14] For example, in the case of Colombia's reform of the early 1980s, a major export turned out to be of cut flowers, but prior to the reform no such exports existed and moreover no one had predicted success in this industry.

introduced, and other new firms (almost inevitably SMEs) made willing to invest in export industries.

The especially strong trade liberalizations undertaken by Taiwan, Korea and Chile reviewed above were examples in which all these features were involved and the commitments made were deemed credible and therefore the programs successful. The commitment to maintaining constant real exchange rates and depreciations timed in such a way as to offset the tariff and NTB reductions were absolutely crucial.[15] In all three cases, those "selling" the reforms articulated just how the potentially negative effects on strong groups would be offset. Many other countries which have not liberalized or done so only timidly and tentatively have not been able to make such commitments and, even if the could have, their commitments would probably not be deemed credible.

In Taiwan of the late 1950s, Korea of the late 1960s and Chile of the mid-1970s, the governments were military governments but with strong groups of technocrats advising them. The fact that the leaders were military may have added to the credibility of their pronouncements, at least to the extent that they attempted to make the programs appear to be equitable and "fair". The internal coherence as well as credibility of the new policies was also made possible by centralizing their design and articulation within the central ministries (Ministry of Finance and Prime Minister) and the Presidency and by the fact that the presidents themselves exerted strong leadership in pressing for and committing the state to the reforms. The design of the programs was in all cases confined to these small groups of technocrats, thereby protecting the programs from dilution and inconsistencies that would be bound to arise if the programs were left for the different ministries and parliament to work out with civil society. In all cases, there were excellent technocrats and bureaucrats that helped to make the promised implementation credible. Thomas, Nash et al (1991) contrast this with Peru of 1980 where, despite a crisis (and the strong need for reform), a strong, centralized leadership was lacking and hence little was done to blunt the potential opposition to liberalization.

Since (1) the vast majority of firms prior to reform in the three countries were SMEs and (2) new exporters would have to arise from the ranks of existing or new SMEs, to enlist SME support for (or at least diffuse their opposition to) reform, SMEs would have to believe that they could expect to operate successfully in and benefit from the proposed new system. Otherwise, SMEs would tend to fear that large multinational enterprises (MNCs) and conglomerates of enterprises

[15] See Edwards and Lederman (1998) for a detailed political economy analysis of the Chilean case.

would be the ones to capture the opportunities and twist the administration and implementation of the programs to their advantage.

In the Chilean case, this was taken care of to some extent by the combination of (1) very rapid reductions in NTBs and tariffs, (2) the unusually high degree of homogeneity in these rates applying to all producers, and (3) depreciation of the exchange rate. None of these could be perceived as benefiting large firms any more than small ones. In the Taiwanese and Korean cases, however, since the tariff reductions came considerably later than in the Chilean trade liberalization, another key commitment was to the duty drawback system. In principal, the duty drawback system, like import licensing and NTBs, would seem to have the potential for being discriminatory to the disadvantage of SMEs. There was paperwork and numerous procedures to go through in order to qualify for and actually obtain the rebates. Yet, in practice, in both Taiwan and Korea, the system was designed in such a way that it became easy for SMEs to benefit just as easily as large firms. Large input suppliers could collect the receipts of SME exporters and thereby themselves get reimbursed (without the SME exporters having to go through all the steps themselves) or small parts or input suppliers could be reimbursed for the duties paid on imported inputs from their large direct exporters once the latter could demonstrate the fact of their exports to the authorities. In this way there was cooperation between direct and indirect exporters and between SMEs and large enterprises (LEs).

This may seem like an administrative detail of little consequence. Yet, Thomas, Nash et al (1991) and World Bank (1992) cite the programs of Indonesia and Thailand as inferior for not having these procedures. An even more telling example is that of Pakistan which obtained a loan from the World Bank for its program of trade liberalization. This program was supposed to be a copy of the Korean program, including its already well-functioning duty drawback program. Yet, in Pakistan’s program agreement between direct and indirect exporters on the sharing of the rebates could not be obtained (perhaps because the party doing the procedure might be deemed to have a better chance of taking advantage of over-invoicing of imported inputs). As a result, the program was never extended to indirect exporters. Not only did this make the country’s long-term commitment to a well functioning program that much less credible, but also it inhibited the development of healthy subcontracting between LEs and SMEs. Healthy cooperative relations between LEs and SMEs, moreover, would help solve the otherwise difficult collective action and free riding problems of SMEs. Otherwise, because of the vulnerability of large and dispersed groups like SMEs to free-riding problems, collective action in support of trade liberalization by otherwise hard-to-organize SMEs may be found wanting. This comparison of Pakistan's and Korea's duty drawback systems illustrates how the effectiveness of formal legal institutions depends on the functioning of informal and private institutions and the ability of private parties to make the transitions that produce the gains from trade.

Hence, the fundamental obstacle to the adoption of trade liberalization is the problem of credible commitment on the part of government to a package of measures designed to give the beneficiaries of different sizes and types the confidence that these benefits will be forthcoming for a sufficiently long period to justify their support for the program and investments in export and efficient import-competing activities. If the commitment to any one component of the program is deemed not credible, the trade liberalization program may be doomed to failure.

Note that all the above successful cases were early reformers. Later reformers can take advantage of the past experience, and knowledge of how successes were obtained and failures avoided. Yet, it also means that the harmful side effects of such programs that have been obtained in otherwise successful cases of trade liberalization can be anticipated. Hence, concerns for the possibility of high unemployment rates, increased income inequality, government revenue shortfalls (and hence fiscal crises), excess burden on public services, increased pollution and environmental degradation are bound to surface. When they do, they can indeed impede the adoption of trade liberalization. Only if such opposition can be defused by credible commitments to measures designed to avoid, or at least greatly mitigate, such problems can liberalization be adopted. Hence, another and related obstacle to the primary one identified above is the ability of a government to be able to credibly commit to efficient, sustainable and reliable means of overcoming, or at least considerably mitigating, these problems. This could mean credibly committing to the maintenance of social safety systems, worker and managerial training programs[16], pollution monitoring systems and incentives designed to induce firms, households and governments to conserve on the use of energy and other resources which result in pollution, and to reduce emissions, and to introduce educational programs and capital and labor market reforms designed to increase factor mobility. All this must be done in the face of possible budgetary problems and efforts to reduce the size of government.

[16] This is not to deny that designing and implementing effective programs of this sort may be extremely difficult, accounting for why the may be so rare.

In the vast majority of countries where trade liberalization has not yet been seriously attempted, one can suspect that governments are either unable or unwilling to make credible commitments to such programs. In the other papers presented in this workshop we will attempt to identify some alternative institutional hypotheses about how these problems might be overcome.

It would be quite ingenuous not to mention that many factors may affect the likelihood that a government may overcome these obstacles and make the needed commitment. Several that have been identified most frequently in the literature are: the extent of an existing crisis (deemed to require rather drastic action and a change from the status quo even if there is a cost to be paid), the coincidence of a major change in government leadership, such as the entry or exit of a military government, (so that the blame for the crisis and the pain ahead can be blamed on the predecessors), the extent to which the new government in its economic ministries is permeated by economist technocrats (who may be less sensitive to party and special interest political pressures), the length of time the ISI regime has been in place, and certain structural characteristics such as the degree of income inequality (consensus being more difficult to achieve when inequality is high), and the commodity concentration of exports.

4. Obstacles to Reform Implementation: Why Have the Trade Reforms Adopted Often Been Tentative, Discontinued or Even Reversed in Subsequent Years?

Various surveys of trade liberalization experience have shown that substantial percentages of them are either too timid, tentative or incomplete to be identified as successful or discontinued or even reversed after a few years. The percentages of liberalization attempts ending in these ways depends of course on where one draws the line between success and failure. Typically this is done on the basis of whether or not the country sustains an upward trend in openness, exports relative to GDP, export growth, tariff and NTB reduction etc. for some specified number of years.

Defining this period as the length of a World Bank program loan in support of trade liberalization, and using as the criterion the degree of reduction in the anti-export bias, Thomas, Nash et al. (1991) identify only 17 of the 40 countries that attempted liberalization to have been “quite successful”, 12 as “slightly successful” and the rest “unsuccessful”. In several of the latter, trade liberalization was abandoned and trade policies reversed. Nabli (1990) defined success as sustaining increased openness over four years subsequent to the beginning of the trade liberalization episode. He found that 29 of the 53 trade liberalization episodes were not successful in that sense. Sachs and Warner (1995) developed a more sophisticated index of openness based upon a number of different characteristics (exchange rate misalignment, average tariff, the percentage of commodities covered by quotas, the presence of a monopsonistic export marketing board and having a socialist government) but drew the line between "open" and "closed" in such a way that by 1994 the vast majority of developing and transition economies were classified as "open". Yet, even they identified fifteen countries which had become open (presumably though reform) but then later retrogressed back to a "closed" state. This is obviously a rather extreme version of trade liberalization failure.

For such programs to have been discontinued or reversed, it is implied that difficulties must have arisen in the implementation of the program. There can, of course, be many explanations for these premature terminations in the liberalization programs. First, it could be that the country did not have a team capable of designing and implementing a program sufficiently well designed to be sustainable. This means they must have access to qualified technocrats. While it is true that some countries have been better endowed in good technocrats than others, since such teams could always be hired even if only from abroad, lack of such expertise within the country would hardly seem to be the most important factor.

A more common explanation would seem to be again the inability or unwillingness of government to commit to the type of program that can, in fact, sustain the liberalization for a number of years. Indeed, this inability or unwillingness to commit may be the reason why the country doesn't see the wisdom and importance of hiring the right team to advise them on trade liberalization and its implementation. Consider the following: if either Korea or Chile had **not** been able to honor its commitment to exchange rate depreciation at the beginning of its trade liberalization, could it have been expected to have sustained its program over a period of 25 years or more? Indeed, as noted above, both the strong Chilean trade liberalization program of 1974-79 and the Mexican one of the mid-1980s were interrupted, resulting in serious backsliding in subsequent years. In Chile this was the result of exchange rate appreciation in 1979-82. This appreciation of the real exchange rate has been attributed to: (1) the inflow of capital triggered by the new opportunities the reforms introduced and (2) an ill-fated attempt to fight inflation by holding constant the nominal exchange rate, resulting in large current account deficits and eventually (after a crisis) more capital inflows (Dornbusch and Edwards, 1994). After 1982, the real exchange rate overvaluation was gradually decreased and the country once again returned to trade liberalization. The Mexican experience of the mid 1990s was somewhat similar.

In cases where the liberalization of NTBs and tariffs occurred without the parallel depreciation of previously overvalued real exchange rates, a common consequence has been consumption booms (such as those experienced by Argentina, Chile, Uruguay and Mexico) which led in turn to new rounds of current account crises, debt accumulation and the re-imposition of trade restrictions. Another has been decline in the competitiveness of the new non-traditional exports and the more efficient ISI firms. The synchronization of exchange rate and tariff reduction policies has to be perfect. If, even temporarily, the latter should get ahead of the former, by viewing it as a temporary opportunity, it may be sufficient to induce the unsustainable consumption boom and subsequent financial crunch to suppress it (Calvo 1989). Even without a deliberate policy regime switch, the reduction in savings rates may have the effect of sharply raising interest rates and crowding out investment, once again undermining the feasibility and sustainability of the program and the new export industries. In either case, bankruptcies may kill off or threaten the very interests that can most benefit from and support trade liberalization. If those kinds of firms and workers who are supposed to be the ones most benefited from trade liberalization are in the end left to die in bankruptcies, it will be very hard to sustain trade liberalization. Rather, trade liberalization per se will take the blame for a mere design or implementation flaw and such failures to follow through may set back the cause of trade liberalization for decades.

Another source of non-sustainability in trade liberalization programs comes from revenue shortfalls following tariff reductions. Several cases of this were cited in the preceding section. In this case, tariffication of NTBs could help mitigate this problem, and thereby improve the sustainability of the program. But the commitment to this has to be credible.

A different and much overlooked set of sustainability problems could also arise from changes in the size structure of industry. Unlike the conglomerate, foreign and state firms operating in the ISI regime that are mostly large, many of the new export and import-substituting firms to be fostered in the trade liberalized regime are likely to be small, especially at the beginning. For this reason, success and sustainability of trade liberalization may depend on whether SMEs will be able to access international markets, credit and technology in a low cost manner. Since small firms are much more dependent on markets than large ones, to be viable SMEs also have to have low cost transactional relationships with other firms. These costs derive generally from situations of asymmetric information. There are various means of mitigating this problem and thereby reducing the transaction and other costs for SMEs. Among the methods are the formation of subcontracting relationships with large firms, building clusters of SMEs, and having specialized services supplied to SMEs by industry associations, the state or the market (i.e., other private sector firms).[17] Each such approach has advantages and disadvantages, their comparative advantages depending heavily on country and industry circumstances. Clusters and subcontracting relationships may appear especially important given both their prime importance in the successful East Asian countries and the fact that they are supplied by the private sector, though abuses to the disadvantage of SMEs can certainly arise. Yet, experience has shown that they have to evolve naturally. Attempts to create such networks by government or other intervention have not been successful. This doesn't mean, however, that trade-liberalizing governments necessarily have no influence on the strength and suitability of the different alternatives. To the contrary, experience in Korea's woven textile industry which has a very large cluster type of network has shown that over time the state may be able to do a number of little things with infrastructure or the location of schools that gradually add up to helping such clusters to form and prosper. The aforementioned contrast between Korea and Pakistan in the way in which the duty drawback systems (with both direct and indirect exporters being able to qualify for the drawbacks, the exact method being chosen for convenience of the parties concerned) were developed may well have contributed to the greater sustainability of trade liberalization in Korea. As far as state-supplied services to SMEs, the lessons seem to be that some of the best programs and services are very low in cost, such as facilitating participation of SMEs in international trade fairs. There is also need for the users of such services to evaluate and even design the services desired and choose among various competitors.

A second, though complementary, explanation for lack of sustainability is that the trade liberalization program may have been well-designed but initiated at the wrong time. Arguments about comparative advantage and gains from trade are more plausible when real world conditions approximate those of the theoretical models used to justify them, namely, equilibrium at full employment. Yet, it was during the extremely turbulent and depression-like conditions of the mid-

[17] An interesting example of the latter is the way in which the Chilean export promotion organization has encouraged the supply of services to SMEs from private firms, using a system akin to the school voucher program. SMEs are given vouchers which they can take to private firms in return for services. This has the advantage of allowing using firms to choose among alternative suppliers on the basis of the quality and appropriateness to them of the services offered. This system has been mimicked in Colombia and several other countries.

to-late 1980s and early 1990s that most of the Latin American countries and transition economies of Central and Eastern Europe initiated their trade liberalization programs. One problem is that in such turbulent circumstances, often before stabilization has been achieved and hence both inflation rates and relative prices are very volatile, the price signals exerted by the trade liberalization measures may be either misleading or too noisy to have the “right” effects on resource allocation. This can be an argument for delaying trade liberalization until after stabilization can be achieved. But, if trade liberalization is delayed, it may mean that the stabilization programs that help raise the prospects for investment and future growth may stimulate investments in the “wrong sectors”. At the same time, the currency depreciation required to offset reductions in tariff equivalents may also trigger inflation. Clearly, there are tradeoffs and problems inherent in these inevitable interdependencies. But, whether, stabilization occurs before, after or simultaneously with trade liberalization (if at all), it suggests that the need for a well-articulated, coherent and credible program is even more demanding and larger than would be the case if trade liberalization was to start from a stable, full employment economy.

A third problem is that trade liberalization, and capital market liberalization (often a concomitant of trade liberalization), is likely to increase the vulnerability of the economy to new kinds of shocks. These shocks can easily be very challenging to policy makers and make it even harder to stick with reforms. Both Chile of the 1970s and Mexico of the mid-1990s were heavily indebted and then buffeted by unexpected shocks in the form of higher interest rates in the US. Indeed, some analysts blame the setbacks of Mexico and Chile in their trade liberalization programs on mere bad luck. Even if this is not entirely true, it is quite true that, even if the trade liberalization programs had been well-designed for normal condition over time, they may not have been sufficiently well designed to also withstand the severe external shocks that may be more likely to come in a liberalized economy.

Another important factor in the failure to sustain a trade liberalization program may be high adjustment costs of moving from one trade regime to another. Assuming that these costs are borne privately by the entrepreneurs and workers who need to change locations, industries and technologies, if these costs are high enough, they can prevent adjustments from taking place and hence any of the expected reallocation effects from being realized. If so, the benefits of reform will not be realized and the program will not be sustainable. If there should be doubts as to the sustainability of the reforms, this can add further to the adjustment costs since the costs of moving back to the old regime would also have to be considered, further raising the prospect that forward-looking investors and workers will find the costs of adjustment too large to bear (Rodrik 1992). Since the evidence on long unemployment spells resulting from trade liberalization in Chile, with one of the most credible trade liberalization programs, is quite strong, it would seem quite clear that the sustainability of such programs should require also a credible program of public sharing of these costs and/or measures for reducing the costs as much as possible.

There are several features of the Korean case that stand out as to how the adjustment costs were kept much lower than in other trade-liberalizing countries. First, because of the strength of its commitment to success in liberalization and rapid economic growth, the government did not hesitate to borrow heavily to get through adverse shocks and cyclical downturns rather than to going through the more conventional austerity programs. This allowed profits to remain high, sustaining a high rate of export-led private investment. Second, the labor force was well-educated and because of a starting point of a rural labor surplus, it was relatively easy to get young people from the rural areas to move to towns and cities for employment. Third, the Korean government tolerated or even encouraged conglomerates (Chaebols) which could shift scarce resources like capital, skilled labor and workers easily from one industry to another. Fourth, the tariff reductions were by no means rushed and were not simultaneous. The government announced its reductions several years in advance and once announced did not back down. To encourage new export industries, it often promised protection for a limited number of years, giving firms sufficient time to learn to be competitive without protection. Fifth, and as an alternative to having to rely on foreign investment, the government set up thick networks of technological, financial and marketing support for firms of all sizes. Financing was available equally to firms for export industries and to older firms that wanted to upgrade their equipment and technology in order to remain competitive. Beginning in the early 1980s, these sources of support were increasingly directed to SMEs as the chaebols and other large firms no longer needed such help. Amsden (1989) called special attention to government support to subcontractors and to a new legal institutional regime set up to protect subcontractors from capricious contractors in the contractual relations. After this was done, subcontracting began to flourish.

The costs of adjustment are of course unlikely to be uniform across the population and its groups. Some are bound to be losers. Even in the long run, for losers the future benefits will not outweigh the present and future costs. Since the identity of the losers may not be known ex ante, the losers may well begin to pressure for discontinuing the reforms only after liberalization is in progress. Safety nets and compensation programs may be one solution to such problems but perhaps not the most cost-effective one. Pacing exchange rate depreciation with tariff reduction may go a long way toward reducing the need for redistribution mechanisms.

Another fact of life during trade liberalization reforms may be that the costs of adjustment turn out to be higher than anticipated. When this happens, the individuals and groups affected, most likely firms and their workers in certain sectors, are likely to petition the state for exemptions from the trade liberalization program rules. The more complicated are the rules to start with, the harder it will be for the reformist government to resist pressures to grant such concessions. Simple rules are much easier to defend since the granting of exemptions in individual cases is more likely to be seen as alien to the regime and hence unacceptable.

Most evaluations of the adjustment costs of trade liberalization have pertained to existing firms. Yet, empirical studies of entry and exit have repeatedly shown that, even in stable, relatively slow-growing economies, the vast majority of jobs are created in new firms the vast majority of which are small. Other studies have shown that much of any economy's (total factor) productivity (TFP) increases arise from this process of new firms entering with new ideas and technology and older firms with less innovative products and technology exiting. From this point of view, the ingredients of sustainability of the reform may well hinge on combining TFP growth with employment generation through new firm development. Policies for achieving this objective may be very different than those needed to help firms survive the negative short-term consequences of reform. While the former might seem to require credit programs and government procurement in times of need, the latter might suggest just the opposite, doing nothing to artificially help existing firms to stay in business but everything to allow new firms to enter.

The greater is the number and seriousness of the problems of this sort that have to be dealt with if the program is to be sustainable, the more difficult the credibility problem is likely to be. Credibility is needed not only for the trade liberalization to be initiated but even more importantly for it to be sustained. This is a tall order. What can be done? One choice to be made is with respect to the pace of reform: Big Bang or Gradual and Piece-meal?. The internal consistency problem could be taken care of via the big bang, i.e., completing all aspects of the liberalization program instantaneously and simultaneously. But this might well greatly increase both the adjustment costs and the possibility of large errors that could undermine sustainability. From this point of view, therefore, gradual, one-at-a time reforms might be more advantageous than radical ones. In other words, demonstrated success in these early individual steps may greatly enhance the credibility of the sustainability and success of the program. But gradualism raises the possibility that the reforming government may well want to look as if it is going to keep liberalizing but then surprise people by reneging on its actual or implied commitments.

While each of the above explanations for lack of sustainability of trade liberalization applies to governments that are in fact deeply committed to reform, certainly another factor can be the lack of such commitment. External support for trade liberalization programs may contribute to this. Given that many of the reforms began in crisis conditions when countries were burdened by debt and running sizable current account deficits, they were anxious to obtain loans from international agencies like the World Bank that were willing and able to lend to countries which adopted trade liberalization and structural adjustment programs. While on the one hand, external support for such programs can help make the programs more sustainable by helping the countries get through the anticipated adjustment period, on the other hand, the availability of such support may induce countries not genuinely interested in trade reform to initiate such programs (Rodrik 1989). Supporting countries whose leaders do not have a genuine interest in trade liberalization may have three extremely harmful effects and therefore should be avoided. First, the likelihood that such reforms will be sustained is minimal. Second, when such trade liberalization programs end in failure, it gives trade liberalization an undeservedly bad reputation, thereby lowering the likelihood that additional countries will undertake reforms. Third, to make matters even worse, the actions of these countries which pose as trade reformers to get the financial support (but are not truly committed to the reforms) may make matters worse for the true reformers since additional conditions may be imposed by the agencies, thereby making the programs less politically acceptable at home. This in turn may undermine the sustainability of the reforms. Another related problem with external support for such programs is that domestic groups may well see the program as being imposed on them by these international agencies, thereby undermining the legitimacy and hence long-term credibility of these programs.

While there are thus a wide variety of problems that can lead to the non-sustainability of trade liberalization, the salient ones seem to be:

(1) The government's inability to credibly commit to a coherent program that is free from the internal inconsistencies that seem endemic in trade liberalization. Without

overcoming these obstacles, the suspension, abandonment or even wholesale reversal of such programs is likely.

(2) Also credible must be its commitment to reduce and/or redistribute the adjustment costs and either compensate losers or reduce the need to do so. If such problems are not mitigated, trade liberalization programs are unlikely to be sustained. At the same time, these problems should be overcome in a manner that does not sacrifice the basic rules of the program, e.g., by allowing exemptions from liberalization for certain activities or higher tariffs for those sectors that scream the loudest for protection.

(3) In the LDC trade liberalization context, where new firms are even more likely than in DCs to be small SMEs, an important obstacle to sustainability is the information asymmetry and transaction cost problems that are especially serious for SMEs. Since these firms are crucial to the sustenance of trade liberalization, free rider problems of their ability to exercise collective action need to be overcome.

5. Obstacles to Post-reform Responses: Why Have the Countries that Have Had Trade Liberalization Reforms Also Had Such Noticeable Unwanted Effects?

In this ex post stage of trade liberalization, i.e., after trade liberalization has matured, several trade-liberalized countries remain saddled with lingering unwanted effects of trade liberalization.

From Table 2 it can be seen that for virtually all trade liberalizing countries, income inequality (as measured by the Gini coefficient) has remained higher than in all but one or two of all pre-liberalizing years for which such data exists. The increases in inequality have been especially noticeable in those countries such as Chile, Argentina, Brazil, and Mexico whose trade liberalization programs have been the most ambitious. A couple of qualifications, however, are in order. First, even non-liberalizing countries have generally experienced rising income inequality over the period covered. Second, many other factors such as technology and migration flows may have been changing in ways that may have increased income inequality. To properly distinguish the effects of trade liberalization from other, perhaps interrelated, factors like technological change would require a model capable of simulating the effects independently. This we have not done. Nevertheless, compared with the outcome of Korea and Taiwan in which income inequality has remained low even after thirty years of trade liberalization, the rise in income inequality in these trade-liberalizing countries is very worrisome indeed. The fact that increased inequality has also occurred during an era in which safety nets and various state welfare programs have been reduced has meant that poverty has actually increased in several of these countries.

To overcome this obstacle, the best solutions are to promote basic and general education, thereby increasing labor mobility and encouraging technological change, and to develop specialized retraining programs. Yet, the typical public sector training program is most unlikely to do the job in that they are seldom sufficiently specific to the needs at hand or well run. As a result, their services are often very poorly rated by users. What is needed, therefore, is competitive private sector supply orchestrated by the public sector or industry associations.[18]

The unwanted environmental effects that countries like Indonesia and Chile have confronted have been another problem. These effects once they occur are very expensive to reverse. Hence, the best approach is to set up appropriate monitoring and enforcement programs before hand. The integrity of any such system, of course, has to be continuously monitored and enforced. Another frequent cause of some of the environmental problems is the absence of clearly defined property rights. Without such rights, the owners of the resource will not be able to internalize the negative external effects on the environment and thus have little incentive to mitigate resource misuse, such as haphazard deforestation in the name of lumber exports. Indonesia's experience with sandalwood exports narrated by Marks (2001) provides a case in point. Sandalwood trees produce a fragrant wood with sandalwood oil. Technically, it is best to let the tree grow to its maturity of 50 years before cutting it for its wood and oil and only after twenty years of age is the tree capable of producing seedlings with a reasonable chance of survival. Yet, if property rights are uncertain, it may be economically profitable to cut the trees well before the trees have reached maturity, but thereby lowering productivity, natural growth of the trees and the value of the forest in the long run. In 1986 the Governor of Nusa Tenggara Timur (NTT) Province claimed ownership for the provincial government of all sandalwood that grew on government land or even on private land not exclusively dedicated to sandalwood production. This act specifically rejected long-standing property rights claims by the residents of the public lands who had been managing the sandalwood forests. The Governor's decree also regulated sandalwood sales in such a way that the "producer" (the one bringing in sandalwood for sale) and former owner (if private) would get only a tiny fraction of the export price and imposed a ceiling on total sandalwood sales and cutting. Exports

[18] Again see Levy, Berry and Nugent (1999) for numerous examples.

were also taxed at rates varying quite sharply according to size, weight and other characteristics of the wood, giving considerable incentive to misclassification of the wood. Not surprisingly, these regulations gave rise to corruption and also created a lively black market in sandalwood wherein smuggler would pay producers a price considerably higher than that they could get from the government. In an effort to bring the clandestine trade to an end, in 1997 the provincial government issues a temporary exemption on the controls for all previously cut wood, thereby offering to anyone who brought the wood a temporarily higher price for the wood. The supply response, including of course freshly cut wood, was totally unprecedented, leading to the sudden decimation of the sandalwood forests, including young trees, thereby lowering future production of sandalwood in the region.

It should be recalled that most of the new jobs created and the increased total factor productivity in domestic manufacturing come from new firms. For this reason, one important reason for the failure of networks of new exporting SMEs to develop is the high transaction costs of setting up and operating SMEs. Excessively rigid, time consuming and costly registration procedures and the multiplicity of authorizations that are often required prior to registration and production can contribute very substantially to the failure of exports to respond to the extent anticipated or possible (de Soto 1990). Not only is registration more difficult for new and small SMEs but so are numerous other administrative procedures as well. These include gaining access to restricted imports, credit, electricity and telephones, including the programs of special relevance to the success of trade liberalization such as duty drawbacks. Still another problem for new SMEs is the differentially higher costs of dispute resolution. Whereas large state enterprises and even large private ones may have relatively easy access to the court system and the court system tends to be biased in favor of the state and its enterprises, SMEs have no such facility or favoritism.

What can be done to overcome these problems of new and exporting SMEs? Obviously, each problem is different and calls for a different solution or set of solutions. For example, entry and exit requires the stream-lining of administrative procedures and the establishment of one-stop service centers for SMEs. The dispute resolution problems of SMEs may be alleviated at least somewhat by allowing them to make use of more informal systems such as simplified arbitration and mediation procedures. This is likely to work, however, only if the formal legal system recognizes the validity of judgments arrived at in the informal system. Similarly, the need for accessing restricted and licensed imports and other inputs should be reduced as much as possible though deregulation and encouraging all such services (water, electricity, credit, imports, etc.) to be priced at market prices and fostering as much competition as possible among alternative suppliers. Chile has done this for electricity, education, technical training, and information services, all services of special importance to SMEs.[19] Indeed, many other countries have subsequently tried to adopt modified versions of Chile's approach.

In cases where the initial penetration of international markets by non-traditional exporters has been by large firms, another problem has been the low linkages between large firms and SMEs. Even if large firm exports have grown rapidly, seldom has this resulted in rapidly increasing employment. As noted above, this is has often been because the lead in non-traditional exports has been taken by large MNCs that set up plants in the maquila enclaves of the host country, such as INTEL in Costa Rica, IBM and Hewlett-Packard in Mexico. As Ruiz (2002) notes, it can sometimes take a long time for these companies to be able to draw upon a cluster of local suppliers, thereby greatly limiting the benefits to the host country and the number and relative importance of SMEs. In these circumstances, multiplier and linkage effects of the export expansions to other firms and sectors tend to be low (Alarcon and Zepeda 2002).

Subcontracting and other inter-firm relationships can be very useful in this context. While as noted in the previous section, these cannot be artificially created, the government, and NGOs such as industry associations can do a great deal to foster the development of healthy relationships of this sort. An important objective is for the transaction costs, including the costs of dispute resolution, to be minimized. As noted above, the superior experience of Korea over Pakistan in the extent and character of subcontracting can be partly attributed to the way in which the program facilitated SME-LE interaction in Korea but not in Pakistan. In most cases, these arrangements and associations should be voluntary since exit and competition in the supply of such services is highly desirable if not absolutely essential for efficiency. Yet, just eliminating mandatory membership in such associations (as Mexico has done) is hardly likely to be enough. The Chilean model in which state agencies or NGOs foster the development of alternative suppliers of such services, perhaps by at first subsidizing their use with a voucher program, seems a better alternative.

To summarize, therefore, the obstacles to satisfactory ex post performance of trade liberalization would seem to be the following:

(1) An inadequate and/or inappropriate legal, regulatory and judicial system.

[19] See for example, Spiller and Martorell (1996) and Levy, Berry and Nugent (1999).

(2) The inability to commit to cost effective means of treating environmental and other externalities. Since the costs of treating these problems ex post are often extremely high relative to those of preventing them from occurring in the first place, prevention via a practical monitoring and enforcement system is likely to be more cost effective than pollution clean-up and other ex post treatments. Once again, however, credibility of the sustenance of the program is crucial.

(3) The high transaction costs to SMEs of accessing information, carrying out transactions, writing, monitoring and enforcing contracts etc. and of relating them to LEs. As noted above, this in turn can depend on the absence of networks among SMEs and with LEs.

6. Conclusions

On the basis of the theory and experience with trade liberalization programs surveyed in the previous sections, the key players in trade liberalization, namely, firms, households, intermediaries, government and external agents, are identified in Figure 1. Also shown are some of the important flows between them. These include exchanges of goods, services, information, technology, political pressures and the policies (including trade liberalization instruments) that affect the incentives and institutional rules affecting the behavior of the different players both within and outside of markets. The diagram should be interpreted in a dynamic sense since the various flows are by no means simultaneous.

Our review of the experience with trade liberalization programs has shown that trade liberalization can have desirable effects but that often the results have been problematic and at best mixed. The obstacles to success are embedded in deep institutional problems. The nature of these obstacles varies considerably from one stage to another in the trade liberalization process. In other words, although there is some overlap between stages, the obstacles to the adoption of trade liberalization differ from those that arise either in the implementation and sustenance of trade liberalization or in affecting the long term private responses to of trade liberalization. Altogether six different obstacles to adoption and success are identified. Clearly, for long-term success, it is important to keep the different obstacles in mind and the time at which they are likely to be most important.

To that end, Table 3 identifies the obstacles that are most important in each different phase of trade liberalization. As noted above, it is important to consider the benefits and costs of the different instruments of trade liberalization. Therefore, in Table 4 this is done also for each instrument or mechanism of trade liberalization. We have seen that, at this level especially, there are important tradeoffs. The seriousness of the commitment problem can be reduced by greater gradualism but gradualism puts more emphasis on the resistances and economic obstacles to success.

Among the specific conclusions that can be drawn from the trade-liberalization experience are: (1) that institutions matter, (2) that small differences in rules may make big differences in results, (3) that different agents have an almost irrepressible inclination to practice opportunistic behavior at the expense of others, (4) that there is no unique best way of overcoming the various obstacles to success for all countries and time periods, and (5) that careful consideration should be given to the best strategy of dealing with the obstacles, including the pace of liberalization, the sequences among the various steps and the best method of overcoming the obstacles within each stage of the process.

Given the importance of institutional aspects to success and failure in trade liberalization, it remains for the subsequent presentations in this forum to spell out these institutional and other alternatives and to explain how these choices can be made in terms of the HPI Methodology of the New Institutional Economics(NIE).

If even with the appropriate insights from the NIE and hindsight afforded from studying past experience with trade liberalization, trade liberalization cannot provide a better balance of benefits and costs than in the recent past, researchers and policy makers alike may have to come alternative and perhaps startling conclusions. For example, this might indicate that trade liberalization may deserve lower priority from policy makers than it has been allocated in the last couple of decades and that trade theory should be re-thought quite possibly putting much more emphasis on dynamic factors like investment effects and technological change which may be harder to generalize.

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Table 1
Average Barriers to Trade Indicators by Region, 1996-98

Region	Average Unweighted Tariff Rate	Standard Deviation Of Tariff Rates	Percent of Countries with Restrictions on CA transactions	Black Market Premium (Percent of Deviation from the primary Rate)	Percent of Commodities Subject to NTBs
South Asia	32	14	40	10.1	58.13
Sub-Saharan Africa	18	12	39	32	10.4
Middle East and North Africa	23	23	33	46.5	16.6
Transition Economies of Europe and Central Asia	10	-	47	-	-
Latin America and the Caribbean	13	8.6	17	4.4	8

Note: - indicates that the figures are not available.

Source: World Bank, *Global Economic Prospects and the Developing Countries*, 2001. Washington, D.C.: World Bank, pp. 53-54.

Table 2 Indexes of Income Inequality (Gini Coefficients) by Country and Year from Different Sources

Year	Argentina	Brazil	Chile	Costa Rica	Mexico	Peru	South Korea	Taiwan	Indonesia	Ghana	U.S.A
1970	36.10 [a]	57.61			45.54		33.30 [a]	29.42 [a]	34.60 [a]		39.40
1971				44.40		55.00 [a]	36.01				39.60
1972	33.40 [a]	61.00 [a]						29.02 [a]			40.10
1973			45.00 [a]					33.60 [a]			39.70
1974	36.00 [a]	55.34 [a]	44.99 [a]	45.20 [a]				28.09 [a]			39.50
1975	36.60 [a]		47.12 [a]		57.90 [a]			31.20 [a]			39.70
1976		60.29 [a]	53.80 [a]	45.00 [a]			39.10 [a]	28.40 [a]	31.80 [a]		39.80
1977			52.60 [a]	43.00 [a]	50.00 [a]		39.10 [a]	28.00 [a]			40.20
1978		56.00 [a]	51.97 [a]					28.43 [a]	34.80 [a]		40.20
1979		59.44 [a]	51.79 [a]	45.00 [a]				27.70 [a]			40.40
1980	41.00 [a]	57.78	52.57 [a]	42.37 [a]			38.63	27.96 [a]	31.80 [a]		40.30
1981	42.00 [a]	55.42	52.15 [a]	47.49 [a]		49.33 [a]		28.22	30.90 [a]		40.60
1982		54.19 [a]	53.91 [a]	42.00 [a]			35.70 [a]	28.49			41.20
1983		57.00 [a]	54.20 [a]	47.00 [a]				28.86			41.40
1984			55.50 [a]	40.55 [a]	50.58 [a]			28.81	30.80 [a]		41.50
1985		61.76 [a]	53.20 [a]				34.54	29.22			41.90
1986		54.52	53.90 [a]	42.00 [a]		42.76 [a]		29.75			42.50
1987		56.18	53.10 [a]					29.84	32.00 [a]		42.60
1988							33.64	30.27		35.90 [a]	42.70
1989	47.59 [a]	59.60 [a]		46.07 [a]	53.09			30.24		36.74 [a]	43.10
1990	43.12		54.70			43.81 [a]		31.12	33.18 [a]		42.80
1991	44.14		55.38 [a]	46.13		46.43		30.77		33.97 [a]	42.80
1992	43.56	58.09	52.19		53.41			31.23		33.91 [a]	43.40
1993		60.64		45.49			31.60 [b]	31.53	31.69 [a]		45.40
1994	43.76		55.58		53.61	48.32		31.84			45.60

1995	46.26	59.91		45.70	53.7 [b]			31.70			45.00
1996	45.84	59.65	56.37	47.00 [b]	52.76	46.20 [b]		31.67	36.5 [b]		45.50
1997	44.84	59.10 [c]		45.90 [d]		50.55		31.88		32.7 [b]	45.90
1998	46.66	60.7 [d]	56.7 [d]		53.10 [d]					39.60 [c]	

Source: UNU/WIDER-UNDP World Income Inequality Database, Version 1.0, 12 September, 2000

a. Deininger and Squire Data Set
b. World Development Indicators 2000
c. World Development Indicators 2001
d. World Development Indicators 2002

Note: A score of 100 indicates complete inequality, 0 indicates perfect equality.

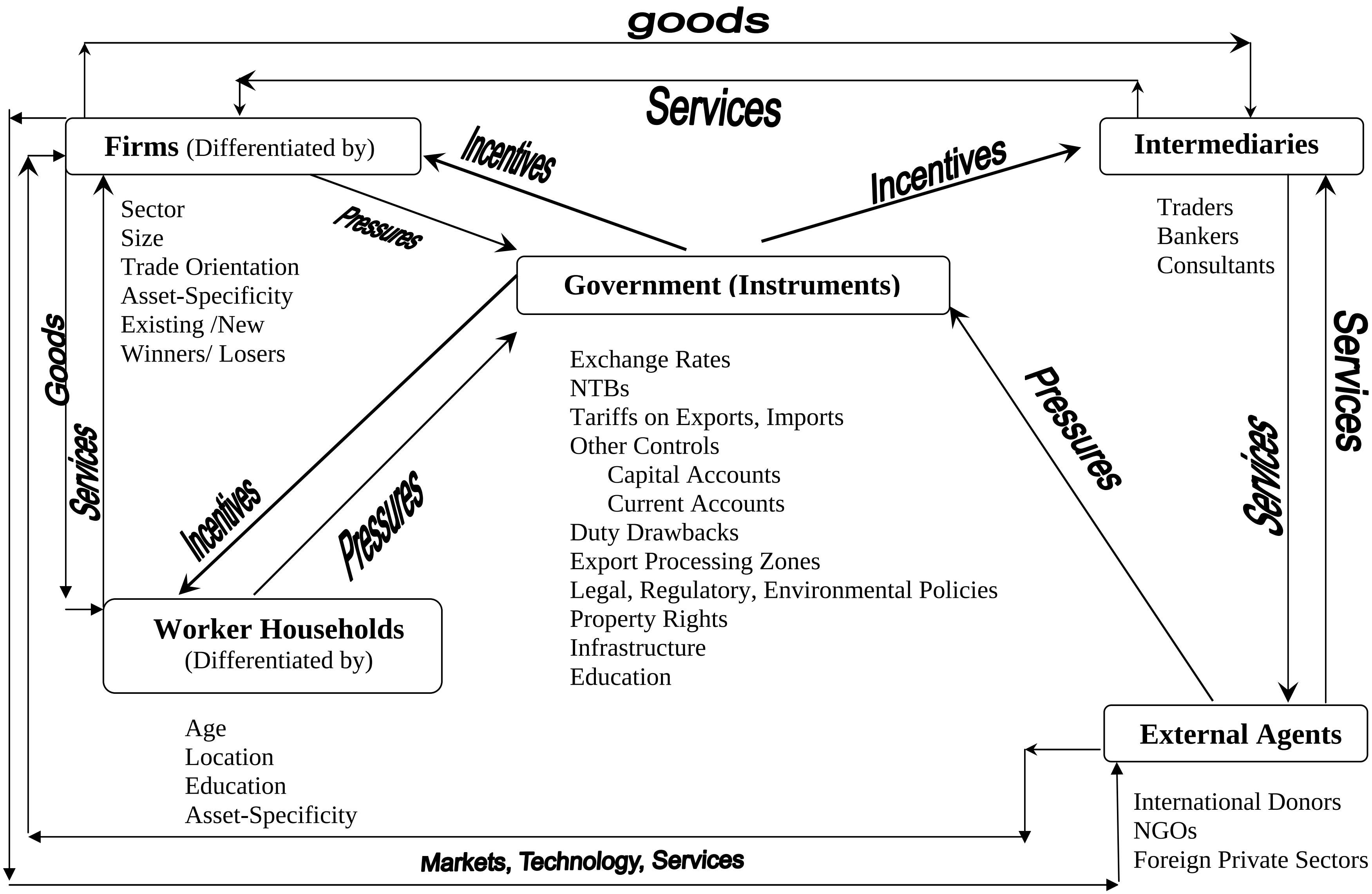
Table 3: A HPI Typology of Obstacles to Realizing Broad-based Benefits from Trade Liberalization.

	HPI Category		
Obstacle	*Pre-reform*	*Reform implementation*	*Post-reform response*
O1. SME obstacles to domestic and international market access gains	X	X	X
O2. Government's inability to commit to future implementation	X	X	
O3. Resistance from owners of asset-specific capital	X	X	
O4. Inappropriate Legal, Regulatory and Juridical Environment			X
O5. Fears of negative externalities to commons	X		X
O6. Economic obstacles to the private sector's response			X

Table 4: HPI Relationships among Trade Liberalization Mechanisms and Obstacles

Trade Liberalization Mechanism	Identity of the Obstacles Encountered in Each Phase with Each Mechanism			
	Pre-Reform	Reform Implementation	Post-Reform	Comments
Exchange Rate Unification and Liberalization	O1, O2, O3, O5	O1, O2, O3	O1, O2, O4, O5, O6	Can Lower Pre-Reform Obstacles by Gradualism
Tariffication and Reduction of NTBs	O1, O2, O3, O5	O1, O2, O3	O1, O4, O5, O6	Can Lower Obstacles by Gradualism
Tariff Reduction	O1, O2, O3, O5	O1, O2, O3	O1, O2, O4, O5, O6	Can Lower Obstacles by Gradualism
Export Processing Zones (EPZs)	O1, O2, O3, O5	O1, O2, O3	O1, O4, O5, O6	Can Lower Obstacles by Gradualism
Duty Drawbacks	O1, O2, O3, O5	O1, O2, O3	O1, O4, O5, O6	Can Lower Obstacles by Gradualism

Figure 1Key Players in a Trade Liberalizing Country



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