The economics of failure

The real cost of 'free' trade for poor countries

A Christian Aid briefing paper

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Trade liberalisation has cost sub-Saharan Africa US$272 billion over the past 20 years. Had they not been forced to liberalise as the price of aid, loans and debt relief, sub-Saharan African countries would have had enough extra income to wipe out their debts and have sufficient left over to pay for every child to be vaccinated and go to school.

Two decades of liberalisation has cost sub-Saharan Africa roughly what it has received in aid. Effectively, this aid did no more than compensate African countries for the losses they sustained by meeting the conditions that were attached to the aid they received. And these losses dwarf the US$40 billion worth of debt relief agreed at the recent meeting of G7 finance ministers.

If new aid and debt relief comes with strings attached that require countries to liberalise trade, it may well do more harm than good. When they meet at Gleneagles, G8 leaders must agree to stop demanding harmful conditions as the price of aid and debt relief.

Introduction

As a major part of its remit to challenge systems that perpetuate poverty, Christian Aid has for many years given a voice to those harmed by trade liberalisation. We have highlighted the plight of farmers who are no longer able to sell their crops when cheap imports flood in and of people made jobless when factories close. These stories of the casualties of unfettered liberalisation need to be told, and we are proud of our role in giving a platform to those who otherwise would not have a voice in international debates.

However, supporters of liberalisation have always argued that these cases represent an unfortunate, but small, minority. They claim that the majority benefit from the new opportunities created by liberalisation. In this briefing, Christian Aid shows that this is not the case. Complementing our previous case studies, which show the devastation trade liberalisation wreaks on individuals, we demonstrate that whole countries would be much richer today if they had not been forced to open their markets.

Christian Aid commissioned an expert in econometrics to work out what might have happened had trade not been liberalised, using economic modelling. The work was reviewed by a panel of academics. The model looked at what trade liberalisation has meant for 32 countries, most in Africa but some in Asia and Latin America.[1]

The data came from the World Bank, International Monetary Fund, United Nations and academic studies. We established the year each country began to liberalise and the extent of its trade liberalisation. We used evidence on the impact of trade liberalisation on imports and exports, and the effect of this on national income, to estimate how much income was lost given the extent of liberalisation. The results suggested that:

- imports tend to rise faster than exports following trade liberalisation
- this results in quantifiable losses in income for some of the poorest countries in the world.

We are not arguing that countries which liberalise do not grow, or that some people in them do not become less poor – but we are saying that without liberalisation, growth could have been higher and poverty reduction faster.

This report shows the true cost of the policies that have been forced on the developing world by donor countries and international institutions. The devastation import liberalisation has caused agricultural and industrial production in developing countries and the way it has severely limited their prospects of future development is well documented. This report puts a value on that loss.

What trade liberalisation has cost Ghana

Ghana began to liberalise trade in 1986. In 2000, its gross domestic product (GDP) was just under US$5 billion. If Ghana had not liberalised, our model suggests that its GDP that year would have been nearly US$850 million higher. Adding the loss every year from 1986 to 2001 (the last year for which we have data) gives a total loss of nearly US$10 billion, or around ten per cent of Ghana's GDP over that period.

In 2000, Ghana lost US$43 for every one of its 20 million people. In the same year, Ghana received aid worth just US$31 per person.

Over the 15 years since trade was liberalised, Ghana's population has lost the equivalent of US$510 per person – a huge sum, given that per capita GDP in 2000 was just US$330. It's as if everyone in Ghana stopped working for one and a half years.

What poor people have paid for trade liberalisation

When trade is liberalised, imports climb steeply as new products flood in. Local producers are priced out of their markets by new, cheaper, better-marketed goods. Exports also tend to grow, but not by as much. Demand for the kind of things sub-Saharan African countries tend to export – such as raw materials – doesn't change much, so there isn't a lot of scope for increasing exports. This means that, overall, local producers are selling less than they were before trade was liberalised.

In the long run, it's production that keeps a country going – and if trade liberalisation means reduced production, in the end it will mean lower incomes. Any gains to consumers in the short term will be wiped out in the long term as their incomes fall and unemployment rises.

This has been the story of sub-Saharan Africa over the past 20 years. Trade liberalisation has cost the 22 African countries in the modelling exercise more than US$170 billion in that time.[2] According to our model, this is the amount that the GDP of these countries would have increased had they not liberalised their trade in the 1980s and 1990s. If the model is applied to all of sub-Saharan Africa, the loss is US$272 billion.

While some countries in Africa have increased their GDP over the past 20 years, this increase is not as great as it could have been. There are more poor people in sub-Saharan Africa now than there were 20 years ago – some of them would not be poor today, were it not for inappropriate trade liberalisation.

In the year 2000 alone, sub-Saharan Africa lost nearly US$45 dollars per person thanks to trade liberalisation. Most trade liberalisation in Africa has been part of the conditions attached to foreign aid, loans and debt relief. This looks like a bad deal: in 2000, aid per person in sub-Saharan Africa was less than half the loss from liberalisation – only US$20. Africa is losing much more than it gains if aid comes with policy strings attached.

The staggering truth is that the US$272 billion liberalisation has cost sub-Saharan Africa would have wiped clean the debt of every country in the region (estimated at US$204 billion) and still left more than enough money to pay for every child to be vaccinated and go to school.

The negative effects of trade liberalisation are not confined to Africa. Low-income countries in Asia and Latin America have suffered similar consequences. The average loss to the countries in Christian Aid's study was about 11 per cent of total GDP over 20 years – amounting to several billion dollars for each country. The total loss for the 32 countries in the study was US$896 billion.

What trade liberalisation has cost Malawi

Malawi began to liberalise trade in 1989. In 2000, its GDP was just over US$1.7 billion. If Malawi had not liberalised, our model suggests that its GDP in 2000 would have been more than US$1.9 billion – US$200 million higher. Adding the loss every year from 1989 to 2001 (the last year for which we have data), gives a total loss of more than US$2 billion, or eight per cent of Malawi's GDP over that period.

In 2000, Malawi's population was 10.3 million and it lost more than US$20 per person thanks to trade liberalisation. In the same year, Malawi received aid worth US$43 per person.

Over the 15 years since trade was liberalised, Malawi's population has lost US$196 per person – a huge sum when you consider that per capita GDP in 2000 was US$165. It's as if everyone in Malawi stopped working for 14 months.

How trade liberalisation hurts poor countries

Academic studies have shown that the main impact of liberalisation on trade flows is to increase the demand for imports at a faster rate than the demand for exports.[3] That is, following trade liberalisation, countries tend to buy more than they sell every year. As a result, their trade balance worsens and they have to live beyond their means, a situation which is not sustainable in the long term, without constant inflows of ever-increasing aid.

As imports increase, demand in the country for locally produced goods falls, because people are buying imported goods instead. The demand for exports doesn't increase enough to make up for the fall in local demand. For farmers, this will mean producing less, or selling at a lower price. For manufacturers, this might mean going out of business altogether.

As a result, developing countries could become increasingly indebted as they continue to spend more than they earn. However, poorer developing countries are highly unlikely to receive the finance – either loans, grants or investment flows – to fund this increased expenditure. Africa, for example, has been a net exporter of capital for much of the 1980s and 1990s.[4] Trade and finance liberalisation have been associated with increased capital flight from Africa. The problem has been compounded by reduced aid to Africa during the 1990s.

If more money doesn't come in from elsewhere, as aid, loans or foreign investment, the impact will be felt on GDP in the medium to long term. As demand for their products falls, local producers earn less, the total income of the country declines and imports eventually return to their pre-liberalisation levels – all of which leads to a lower level of national income than would be the case without trade liberalisation.

What trade liberalisation has cost Uganda

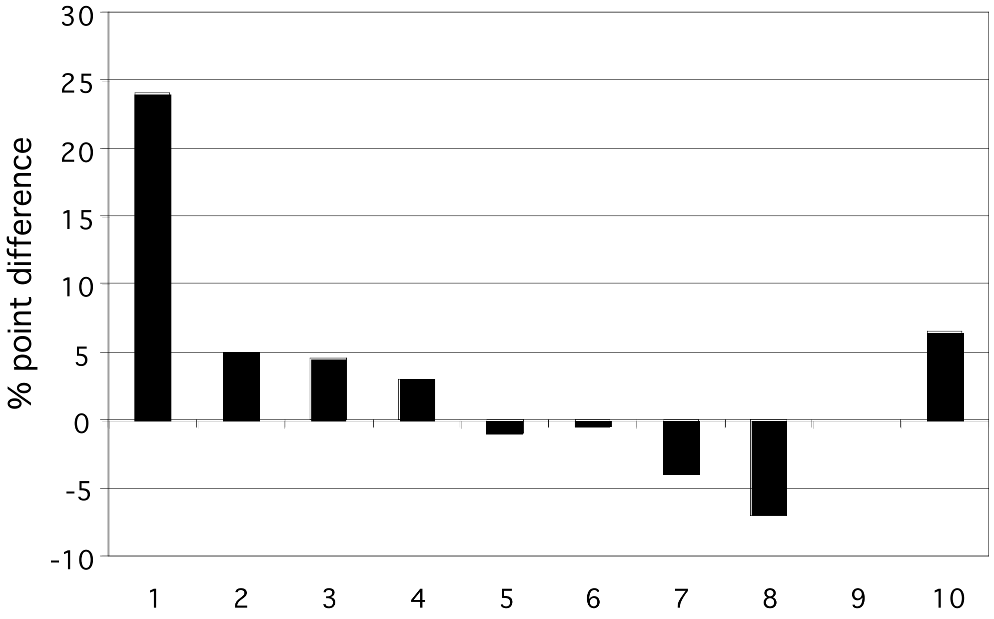
Uganda began to liberalise trade in 1991. In 2000, its GDP was nearly US$6 billion. If the country had not liberalised, our model suggests that its GDP in 2000 would have been over US$735 million higher than it was – more than what Uganda spent on health and education combined that year. Adding the loss every year from 1986 to 2001 (the last year for which we have data), gives a total loss of almost US$5 billion, or eight per cent of Uganda's GDP over that period.

In 2000, Uganda lost US$32 for every one of its 23.3 million people, thanks to trade liberalisation. In the same year, the country received aid worth just US$35 per person. Over the ten years since trade was liberalised, Uganda has lost US$204 per person – compared with a per capita GDP in 2000 of US$253. It's as if everyone in Uganda stopped working for ten months.

Who paid the price?

If a country's GDP falls, it doesn't affect everyone equally. It is often the poor who suffer most. Recent evidence from the United Nations shows that countries which liberalised their trade most tended to suffer from increases in poverty. Countries that cut themselves off from trade altogether don't reduce poverty very successfully either – in fact, it was countries with moderate levels of protection that did best.

Relationship between change in US$1-a-day poverty levels in least-developed countries to extent of trade liberalisation, 1987-89 to 1997-99



IMF index of trade restrictiveness, 1999 (1 = most open, 10 = most restricted)

Anecdotal evidence supports this general trend. Christian Aid has produced numerous case studies over the years which show how poor people have been affected by trade liberalisation.[5]

- Tomato production used to provide rural households in **Senegal** with a good living. But after liberalisation, the prices farmers received for their tomatoes halved, and tomato production fell from 73,000 tonnes in 1990 to just 20,000 tonnes in 1997, leaving many farmers without a cash crop.
- In **Kenya**, both cotton farming and textile production have been hit. Cotton production, a key income earner for poor households, fell from 70,000 bales a year in the mid-1980s to less than 20,000 bales in the mid-1990s. Employment in textile factories fell from 120,000 people to 85,000 in just ten years.
- Rice imports in **Ghana** climbed to 314,626 tonnes per year following trade liberalisation. For local farmers, the results have been catastrophic. One of them told Christian Aid: ‘One of the main problems we face is the marketing of our rice. We find it difficult to compete with imported rice on the market.’

As the examples above indicate, it is often poor farmers who suffer most when trade is liberalised. The fall in domestic demand which results from increased imports hits them particularly hard. Poor farmers have little access to capital or technology to increase their productivity or improve the quality of what they sell in response to more competition. They are also competing in an extremely unequal market, where imports from developed countries are often heavily subsidised.

Manufacturing industries have not grown up to employ people who are no longer able to make a living from farming. Instead, manufacturing has also been hard hit by trade liberalisation:

- In **Zambia**, employment in formal-sector manufacturing fell by 40 per cent in just five years following trade liberalisation.[6]
- In **Ghana**, employment in manufacturing fell from 78,700 in 1987 to 28,000 in 1993 following trade liberalisation.[7]
- In **Malawi**, textile production fell by more than half between 1990 and 1996. Many firms manufacturing consumer goods like soap and cooking oils went out of business, and the poultry industry collapsed in the face of cheap imports.[8]

A closer examination of import and export trends following liberalisation shows how this happened. In all the countries for which it had data, the UN Conference on Trade and Development (Unctad) found that, following trade liberalisation, imports of food increased as a proportion of all imports, while imports of machinery declined, again as a proportion of all imports.[9] The increase in cheap food imports priced farmers out of local markets. The relative decline in imports of machinery showed that manufacturers were also suffering; importing less machinery to run their factories, improve productivity and provide more jobs.

Trade liberalisation means a 'double whammy' for poor people, stifling the development of industry which would replace lost jobs in agriculture. Wherever they turn, poor people are hard hit by trade liberalisation.

Export trends bear this out. Though exports did increase in most cases following trade liberalisation, most countries simply exported more of the same – they did not start to export more manufactured goods, for example, or more higher-value agricultural exports. An Unctad study also found that many least-developed countries lost market share following trade liberalisation, as their exports failed to compete in international markets.[10]

It is clear that trade liberalisation is not driving the development of a more dynamic, diversified or pro-poor pattern of development. On the contrary, it is locking Africa into greater dependence on a few agricultural products whose prices have been declining for 50 years. Liberalisation is hitting manufacturing hard – and it is the development of manufacturing that Africa needs if it is ever to trade its way out of poverty.

What trade liberalisation has cost Mali

Mali began to liberalise its trade in 1991. In 2000, its GDP was US$2.4 billion. Our model suggests that, without trade liberalisation, the country's GDP would have been US$191 million higher in 2000 than it actually was – more than what Mali spent on healthcare during that year. Adding the loss over the ten years since Mali liberalised for which we have data, gives a total of US$1.4 billion.

In 2000, Mali's population was 10.8 million and it lost nearly US$18 dollars per person from trade liberalisation – more than half of the US$33 per person they received in aid. Since the early 1990s, Mali has lost nearly US$130 per person from trade liberalisation – or half a year's income. It is as if everyone in Mali stopped working for six months.

Conclusion

Trade liberalisation is *not* a good policy that has unfortunate consequences for a small minority of people. It is a policy imposed on developing countries by donors and international institutions that has systematically deprived some of the poorest people in the world of opportunities to develop their own economies and end poverty.

Poor people have been driven out of their domestic markets and found no international markets to compensate them. Development has stalled as industries have collapsed and imports of capital goods fallen, exacerbating the crisis in agriculture as fewer employment opportunities are available elsewhere.

African countries have lost hundreds of billions of dollars in 20 years of liberalisation. This means lost opportunities for education, for life-saving medicines and for investment in infrastructure and new industries. Instead, many African countries have seen increases in poverty. Trade liberalisation – and those who have forced it on Africa – must take its share of the blame.

What can be done?

First, the drive to more liberalisation must stop. G8 countries must:

- use their controlling stake in the World Bank and IMF to stop them forcing countries to liberalise trade as a condition of loans, grants and debt relief
- stop forcing countries to liberalise trade as a condition of bilateral aid and debt relief. As a first step, the UK should enact legislation to end the practice of demanding trade liberalisation as the price of UK aid
- support proposals in the WTO for special and differential treatment allowing developing countries not to implement agreements that are not in their interests.

Second, developing countries must be allowed to roll back decades of liberalisation:

- they must be free to raise tariffs if necessary to meet development goals
- technical advice offered to them by multilateral institutions or bilateral donors must include advice on the possible benefits of raising trade barriers as well as liberalising trade.

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Endnotes

1 The countries in the study were: Bangladesh, Benin, Bhutan, Botswana, Burkina Faso, Cambodia, Cameroon, Cape Verde, Ethiopia, the Gambia, Ghana, Guinea, Guinea-Bissau, Haiti, India, Indonesia, Kenya, Lao PDR, Madagascar, Malawi, Mali, Mauritania, Nepal, Nicaragua, Pakistan, Senegal, South Africa, Sudan, Tanzania, Togo, Uganda, Republic of Yemen and Zambia.
2 The information in the following section is taken from Egor Kraev, 'Estimating Demand Side Effects of Trade Liberalisation on GDP of Developing Countries', May 2005, available on request from cmelamed@christian-aid.org
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4 J K Boyce and L Ndikumana (2001) 'Is Africa a net creditor? New estimates of capital flight from severely indebted Sub-Saharan African countries', 1970-1996, University of Massachussetts.
5 See, for example, *The Damage Done: Aid, Death and Dogma*, Christian Aid 2005; For Richer or Poorer: transforming economic partnership between Europe and Africa, Christian Aid 2005; Taking Liberties: Poor people, free trade and trade justice, Christian Aid 2004.
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7 Sanjaya Lall, *Learning from the Asian Tigers*, London: Macmillan, 1997.
8 Unctad, Least Developed Countries Report, 2004.
9 Ibid.
10 Ibid.