

Trade Policy and Poverty Eradication
(With Special Reference to the Egyptian Case)

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Acronyms

ERSAP	Economic Reform and Structural Adjustment Program
FDI	Foreign Direct Investment
GAFTA	Great Arab Free Trade Area
ISO	International Organization of Standardization
MENAP	Middle East and North Africa, Afghanistan, and Pakistan
NTB	Non Tariff Barriers
QIZ	Qualified Industrial Zone
SPS	Sanitary and Phytosanitary Measures Agreement
TBT	Technical Barriers to Trade

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“No society can surely be flourishing and happy of which by far the greater part of the numbers are poor and miserable” (Adam Smith 1976).

Introduction:

Since the 1990s, trade liberalization has been considered by most developing countries as an integral part of economic reform. Poverty reduction has been expected as a normal outcome of rapid economic growth associated with trade liberalization policies. In some countries, like China and India –as will be shown in section one- this has been the case, as notable improvement in living standards has been achieved; however, in most developing countries this expectation did not materialize. Despite economic openness and trade liberalization, poverty rates have accentuated. These conflicting results raise the question as to what extent can trade liberalization policy help in alleviating poverty?

Given the severity of poverty issue in developing countries, the present study attempts to examine the relationship between trade liberalization and poverty reduction, with special emphasis on the possible vehicles that can effectively help in attaining the goal of poverty eradication.

The study begins by a brief review of literature and empirical evidence. It proceeds by considering the channels through which trade policy could affect poverty levels. It then pinpoints complementary policies to effectuate expected

positive effects of trade liberalization on poverty reduction. The study concludes by highlighting the Egyptian case.

Accordingly, the study is classified into four sections following the introduction:

Section One: Trade Policy and Poverty Reduction: Review of Literature and Empirical Evidence

Section Two: Transmission Mechanisms

Section Three: Complementary Policies

Section Four: The Case of Egypt

Section One: Trade Policy and Poverty Reduction: Review of Literature and Empirical Evidence

The Theory

The link between trade policy and poverty has typically been analyzed with reference to the impact of trade liberalization on economic growth, on the one hand, and its impact on income distribution, on the other. The nature of the ‘growth link’ has been controversial, with protagonists arguing that free trade leads to a favourable long-term poverty outcome, with economic growth resulting in a reduction in poverty levels. Others dispute both the link between open trade policies and growth, and that between economic growth and poverty reduction (see, for instance, Edwards, 1998; Frankel and Romer, 1999; Rodriguez and Rodrik, 1999; Dollar, 2001; Dollar and Kraay, 2001a,b; Lübker *et al.*, 2000; Dagdeviran *et al.*, 2000; Kiely, 2004).

The following is a brief review of the theoretical foundation of such a relation between trade and poverty through growth, whether stated explicitly or implicitly.

According to **the traditional classical trade theories**, trade specialization and openness would raise the real income of the country’s relative abundant factor and reduce that of the scarce factor (static welfare gains). This argument is based on two assumptions: full employment and balance of payment equilibrium during trade openness. If these two assumptions are relaxed, the welfare gains of greater specialization may be offset by the welfare loss of unemployment, as well as by the

trade imbalance, if trade liberalization leads to a fast growth of imports relative to exports in the absence of nominal exchange rate adjustment; as experienced by many developing countries that prematurely embarked on trade liberalization (Dodd and Cattaneo, 2006) (Pacheco-Lopez and Thirlwall, 2009).

In this context, the removal of trade barriers could have two counteracting effects. On the one hand, it would induce the development of labor-intensive activities providing employment and income for a large segment of population, particularly the poor. But, on the other hand, such removal may harm protected industries and their employment status, resulting in distributional effects. To outweigh the latter and ensure net overall gains, trade adjustment assistance is often recommended as a compensation for loss arising from trade liberalization (Cicoweiz and Conconi, 2008).

The **new trade** theories focused on possible trade dynamic gains trade which arise through greater flow of ideas, new knowledge, investment and economies of scale. If trade is to be an engine of growth, poor countries need to acquire new comparative advantage in goods that have favourable production and demand characteristics. Structure matters for economic growth. New trade theory pioneered by Krugman (1984, 1986, 1994) since the 1980s, showed there is a case for protecting industries with spillovers and externalities, and for using import substitution as a step forward for export promotion. Under conditions of scale economies and imperfect competition, the welfare impact of trade liberalization can be negative, if considered independently from an overall trade policy².

The insights of the new trade theory have more interesting implications with respect to the distributional impact of intra industry trade expansion, being less dramatic than those of inter industry trade. The first, articulated in the models of Krugman (1981, 1982), is an argument that the *long-run* distributional consequences of trade are less important, because the real income of all productive

² Trade policy, defined or viewed as, “the overall structure of incentives to produce and consume, and hence import and or export, tradable goods and services” (Helleiner, 1998: 588), cannot be reduced to trade liberalization.

factors could increase with trade, in contrast to the Stolper-Samuelson result. The second aspect is that the *transitional* costs of adjustment will be less with intra-industry resource reallocation, because it will be easier to reallocate factors to different lines of work within an industry, it could lower the possibility of already poor households falling into poverty as a result of the loss of a wage-earning job (Dodd and Cattaneo, 2006).

According to the most **standard growth** models, the effect of trade on growth is ambiguous. For example, in the neoclassical Solow model (1956), trade cannot affect the steady-state growth rate, because it is treated as an exogenous constant. Yet, in **new growth** theories (Grossman and Helpman (1991a, 1991b) trade does have the potential to raise the growth rate permanently through continuous learning and spillover effects, implying that trade policy can impact the long run rate of growth of an economy in addition to its level of income (Berg and Kreuger, 2003).

Although the **new institutional** economists have not developed a complete theory establishing growth and trade linkage, they claim that trade liberalization could have a positive impact on growth with the setting up of appropriate institutions. Otherwise, trade reforms would be ineffective aggravating income inequality, with the tendency of such reforms to favour those who already have access to factor markets (Duncan and Quang, 2003) (Omoke, 2007).

Empirical Insights:

There is a significant body of empirical studies examining the relationship between trade, growth and poverty. According to the OECD/WTO (2009), trade expansion does lead to higher economic growth. This finding justifies using trade as a tool for development. Historically, few countries have grown over the long term without experiencing a large expansion in trade. The fastest-growing countries have expanded their shares of the global market for goods. In addition, most developing countries with rapid poverty reduction have sustained high economic growth. China, India, Thailand, and Vietnam are good examples to cite, since the 1990s. But still, there are cases where developing countries' experience with trade reform was disappointing as the latter did not deliver the expected economic growth and poverty reduction (Dollar and Kraay, 2001) (Hallaert, 2010).

In addition to the above, the interaction mechanism between trade liberalization, on the one hand and growth and poverty, on the other is not clear. On the aggregate

level there appears to be a strong relationship between trade openness and growth, but the distributional effect may be unfavourable, as trade liberalization is likely to create ‘winners’ and ‘losers’, limiting thereby the impact of freeing trade on poverty reduction and may even entrench further existing inequalities, if poor household are the main losers.

The fact that increased trade generally goes hand-in-hand with more rapid growth (assuming no systematic change in household income distribution), means that expanding trade generally improves the well-being of the poor (Dollar and Kraay, 2001). Sahn, et al. (1997), and Dorosh and Sahn, (2000) have examined the impacts of trade and exchange rate liberalization on income distribution and poverty in Cameroon, Gambia, Madagascar and Niger, using Social Accounting Matrices (SAMS) for the period 1989–93. Their findings show that liberalization of trade and exchange rate benefits poor households in both urban and rural areas. The experience of the two giant economies provides further evidence: China and India managed to achieve faster growth and poverty reduction through greater integration into the world economy, treating such integration as an opportunity rather than as a threat. Both countries suffered from high incidence of poverty with the vast majority of the world’s poor live in the rural areas, realized significant reductions in poverty during 1980-2000 when they grew rapidly³. According to World Bank (2000) estimates, real GDP grew at an annual average rate of 10% in China and 6% in India during these two decades, with a dramatic effect on poverty reduction in both countries, entirely in keeping with the Bhagwati hypothesis of the early 1960s that growth is a principal driver of reduced poverty (Bhagwati and Sirinivasan, 2002).

In effect, in the last five decades, several Asian countries have been successful in reducing poverty, namely, Singapore, Hong Kong, Japan, Taiwan (China) and Korea; and more recently, Chile and Mauritius. All of these countries managed to spur their exports and overall trade, with improving the living standards of the poor and are now active participants in the global trading environment⁴. Vietnam and Bangladesh provide other success stories (see boxes 1 and 2).

³ According to the Asian Development Bank (2000), the incidence of poverty, by agreed measures, declined from 28% in 1978 to 9% in 1998 in China. By the Government of India’s 2000 estimates, poverty incidence fell from 51% in 1977-78 to 27% in 1999-2000

⁴ Although export expansion is the common element to all the success stories of poverty reduction, there are considerable differences in the models of trade policy that these countries have adopted.

BOX 1

Vietnam

After Vietnam opened up its economy, the income of the poor has risen dramatically, and the level of absolute poverty has dropped sharply, from 75% of the population in 1988 to 37% in 1998 (poverty was cut in half in ten years). This could be attributed to Vietnam's embracement of a more open trading system that has boosted exports of rice, produced by most of the poor farmers, and labor intensive products such as footwear (Dollar and Kraay, 2001) (Bhagwati and Sirinivasan, 2002).

BOX 2

Bangladesh

Since late 1980s and continuing through the 1990s, the country undertook a structural adjustment program with trade liberalization at the core. It eliminated import quotas, reduced average tariffs from 300 percent to 32 percent in a decade. Bangladesh also privatized and liberalized its financial sector. As a result, a four-fold increase in export volume took place since the early 1990s. Bangladesh has also experienced increased employment in the manufacturing sector (including an additional two million women employed each year), a one-percent increase in its average rate of GDP growth, and a decline in the incidence of poverty of one percentage point annually.

However, over the same period, Bangladesh has experienced increased inequality in both urban and rural areas, for several reasons. The rapid growth in the supply of female labor from rural areas has dampened wages in industry. The gap between skilled and unskilled wages has grown because of the relative abundance of unskilled labor and the time required to build new skills. The relative returns to agriculture have declined, leaving the large share of the population in rural areas relatively untouched by export-related growth (Bhattachary, 2005).

low uniform tariffs. Korea, Taiwan (China) and Japan (in the early stages) followed restrictive trade policy while adopting offsetting policies for exporters. Others established export Processing Zones (e.g., Mauritius) (Hoekman et al, 2002)

In contrast, other empirical studies revealed, no systematic relationship between trade openness and poor's income, beyond the effect of openness on the overall growth. Using a large panel (137 countries from 1950 to 1999), Dollar and Kray (2001) regressed the income share going to the lowest quintile on mean per capita income in their sample, and found that the income of poorest quintile grows one for one with average incomes and that given growth, openness has a tiny and statistically insignificant effect on income of the poor.

Other studies using panel and cross section data report similar results of no significant evidence of links between openness and changes in the relative well – being of the poor. For example, Cashin et al (2001) analyzed a cross section of countries between 1975 and 1998 and found no significant evidence that any openness variable was associated with pro poor or anti poor growth (Berg and Kreuger, 2003).

While the majority of studies claim that there is a **positive (either direct or indirect) correlation between openness and growth**, some studies conclude that there is little systematic evidence of a relationship between the trade regime and growth, while others conclude that there is a negative impact of trade liberalization on growth. Moreover, there has been debate about the approaches taken by the various studies.

Broadly speaking, empirical studies have employed **cross-country, time series or general equilibrium** approaches in examining the link between trade orientation and economic growth. Recent empirical studies have resorted to more creative strategies including constructing a wide **range of measures of openness** (Dollar 1992; Sachs and Warner 1995; and Edwards 1998) and comparing convergence among groups of liberalizing and non-liberalizing countries (Ben-David 1993). The majority of these studies share the common finding that **openness is associated with more rapid growth**.

Yet these studies are subject to criticism and debate. **One common shortcoming** of these studies, as argued in Rodriguez and Rodrik (1999), has to do with the kinds of indicators of openness used. It is argued that the “trade policy” measures used tend to capture more than just trade policy and are likely to be correlated with other sources of poor economic performance.

Another possible shortcoming of Levine and Renelt (1992) is that the models used for estimation omit plausible control variables. Policies correlated with growth (trade openness, macro-economic stability, small government consumption, rule of law, etc.) are all highly correlated among themselves. Hence, when all of these policies are included in regression analyses, it can be difficult to identify the separate effects of different policies.

Most of the cross-country studies do not treat the causality between trade and growth, adequately. Edwards (1993) claims that many papers of the 1980s are characterized by a lack of care in dealing with issues related to endogeneity and measurement errors.

Rodrik (2001) also emphasizes that openness might be an outcome, rather than a prerequisite of growth; trade policies might be themselves endogenous to growth, where countries choose to liberalize when the time is appropriate (it has been also mentioned that changes in the volume of trade –though used for decades- is an imperfect proxy for changes in trade policy) .

Greenway *et al.* (2002) argue that dynamic misspecification is a further limitation of these empirical studies. By modifying the commonly used specification to capture the dynamic effects of trade liberalization, they find that the impact of an opening trade regime on growth is non-monotonic. In fact, it resembles a J-curve; that is, there is initially a decline in economic performance following trade liberalization before growth takes off (Dollar and Kraay, 2001) (Duncan and Quang, 2003).

To sum up, there is no general consensus both at the theoretical and empirical levels- on a direct relation between trade liberalization creating high growth rates and poverty reduction. The issue is more complex, and sweep generalization ought to be avoided. Trade policy cannot be simply evaluated by considering its direct poverty consequences irrespective of policy interventions. What is of vital importance is to consider the mechanisms and course of actions that should be pursued in order to empower poor to grasp opportunities and minimize adverse consequences of trade reform. The following two sections examine these issues, analyzing channels through which trade impact on poverty could be studied, as well as complementary policies to effectuate such trade impact.

Section Two: Transmission Mechanisms

Changes in trade policy can offer considerable opportunities to improve the living standards of poor households, but can at the same time increase their vulnerability to shocks, causing thereby short- or medium-term adverse impacts.

To properly address the impact of trade policy on the well-being of the poor, a thorough understanding of the channels and transmission mechanisms through which such policy might operate becomes a necessity. These channels are presented as follows:

The Market

Trade openness can affect households directly through the distribution channel, which primarily relates to market prices and availability of goods and services.

The extent to which changes in the price of goods and services affect poor households is very complex, as it depends on a wide range of factors, including the markets integration over time and space, world prices, exchange rates, domestic taxes, transportation and storage costs; but this direct poverty impact of price changes mainly depends on whether poor households are net consumers or net producers of the good or service in question. A decrease in price will benefit net consumers and harm net producers; and vice versa, an increase in price will benefit net producers and harm net consumers.

Trade liberalization helps the poor by lowering prices of basic foods' imports and import substitutes; thus, increasing people's real incomes.

The poor may also benefit from relaxation of export ban or removal of export taxes, to the extent that the poor are net producers of exports (as it is often the case in agriculture).

An open trade regime also permits imports of technologies that can help the poor in the production process, such as the provision of improved seeds and fertilizers, water purification chemicals, simple packaging processes for perishable goods,..etc. (Bannister and Thugge, 2001).

However, the question that remains open is how much of any price change gets passed through to the poor. An $x\%$ change in the border price of a good typically translates into a significantly smaller change for the farmer or consumer because the costs of distribution remain unchanged. The pass-through can even get lost completely, nullifying the impact on the poor if distribution channels are monopolized, through exclusive licensing, or if price changes are not transmitted due to governments' price fixing policies (Winters, 2000b).

Transport and marketing costs tend to insulate local markets from changes in border prices. In fact, local prices in remote rural areas, where the bulk of the poorest segments of population tend to live, may be completely cut off from changes in border prices. In this case, price changes caused by trade liberalization will not exert any impact on the living conditions of the poor.

More important than price changes is market accessibility. If trade liberalization allows imports of basic food items that were previously banned, the impact on the poor can be strongly felt. For example, the relaxation of import restrictions on agricultural inputs in Bangladesh, allowed small farmers to gain access to such inputs raising their productivity (McCulloh, 2005).

The effects might also depend on the extent of spillovers from one market to another. As households adjust to a shock in one market they shift its effect to others. A major attraction of liberalizing agriculture is that the direct beneficiaries – i.e., the farmers – appear to spend much of their extra income on goods and services provided by the poor.

On the other side, economic downwards arising from World integration deepening may be more harmful than fluctuations in domestic markets, as external shocks could exert direct impacts on sectors strongly affecting the well-being of the poor such as agriculture, construction, personal services and simple manufacturers.

The Enterprise

Changes in trade can affect poor households through the enterprise channel, by exerting impacts on profitability, wages and employment.

Cheaper imports –due to trade openness- will typically push down demand for import-competing goods, therefore reducing their domestic price, leading in turn to a decrease in demand for labour and a fall in wage levels and/or employment, especially in the short term.

Alternatively, cheaper imports of production inputs may increase the profitability of other domestic goods, including exports (in case of using imported inputs in the production process), leading to increased production. This may increase the demand for unskilled and semi-skilled labour, creating additional employment, tightening the labour market and driving up wages (Higgins and Prowse, 2010).

The trade impact on wages or employment depends on the flexibility of the **labour market**. If firms are constrained by labor regulations from reducing their workforces, most of the adjustment to changes in relative prices of outputs will be reflected in changes in real wages. If minimum wage legislation prohibits downward adjustments in wages but labor mobility is high, however, adjustment will take place through changes in employment.

In the rural and informal urban sectors of developing countries where the poor are usually concentrated, labor markets usually are highly unregulated and flexible in terms of labour supply. Wages will generally be determined by the requirements of urban and rural subsistence or the next-best employment opportunities that are available. Thus, it is expected that adjustment to trade shocks will take place predominantly through changes in employment. In this case, the costs of trade reform for the poor may be large, and government assistance and intervention may be required to mitigate their impact.

The impact of trade reform on employment and wages also depends on the **initial pattern of protection**, which will have an important bearing on who wins and who loses when that protection is removed. If the pattern favors unskilled workers in agriculture and light manufacturing, as in the case of Mexico in the early 1980s, then the removal of protection could be expected to lower the relative wages of these segments of the labor force (Bannister and Thugge, 2001).

In other cases, freeing trade would manifest a positive employment effect. The cotton market in Zimbabwe is an example of how trade liberalization that eliminated price control, created more opportunities for the poor and how employment rose in the agriculture sector by 40% from 1988 to 1997.

This indicates the importance of the country's preconditions or initial conditions, when considering the trade impact. Trade liberalization can stimulate market

competition and improve the welfare of the poor in situations where there are forced restrictions on the producers, but it can worsen the situation in case protection disappears after the reform

In countries that are relatively abundant in unskilled labour, trade liberalization is expected to boost demand for this factor and help poverty alleviation. However, in many Latin American and some African countries that have very strong endowments of mineral and agricultural resources (rather than labour abundant) trade liberalization would stimulate these primary sectors regardless of the labour intensity issue. Similarly, if the unskilled (illiterate) are primarily employed in non-traded sectors, while exports draw mainly on the semi-skilled (literate) labour force, the net effects on employment may favour the latter (Winters, 2001).

On the other side, trade liberalization can reduce the demand for unskilled labour, if it speeds up the introduction of high technology which only skilled workers can deploy, thus aggravating unemployment and poverty due to job loss. Such short run employment might be translated into a long run poverty trap, if the poor don't have access to education, or if there is no social safety nets programs or if credit markets are imperfect.

In fact, the impact of trade reform on poverty reduction depends **on whether the poor are strongly represented in the type of labour** for which demand has risen. If the poor are mostly in completely unskilled families, while it is semi-skilled labour that receives the boost, poverty will be unaffected – or maybe, indeed, worsened since the gains of one factor of production will be balanced by the losses of at least one other. It also depends on where the wage rate is relative to the poverty line. If wages are pushed up from subsistence to higher levels, or if the sectors expanding their employment offer above poverty-line wages, then poverty will be alleviated (McCulloh, 2005).

In a nutshell, all the above arguments and their explicit or implicit assumptions clearly pinpoint the danger of generalizing statement about the impact of trade liberalization on employment or wages levels and hence the ultimate effect on poverty status.

The Government

The impact of trade reforms on government revenues cannot be easily determined in advance. At the initial stages of trade liberalization, however, replacing

nontariff barriers with tariffs; then reducing the latter and eliminating tariff exemptions will generally increase government revenues.

If initial tariffs are prohibitively high, reducing them can result in higher trade flows, reduce incentives for smuggling and corruption, thus, boosting revenues. Also, simplifying the tariff regime to create a more uniform structure, with just a few tariff rates, improves collective efficiency which could increase fiscal revenues.

But in later stages of reform, there is a general concern that trade reform may lead to lower government revenues due to decreasing tariffs and that, in an effort to maintain macroeconomic stability, governments may cut social expenditures (such as infrastructure, health, education, sanitation and social protection), or implement new taxes that could disproportionately affect the poor. This probability cannot be denied. But for proponents of trade liberalization, the extent to which increases, or decreases, in government revenues derived from trade affect poor people is ultimately a political decision, as it is the duty of the governments to seek alternative non trade sources of revenues. Domestic tax reform (particularly the introduction of broader-based and less distortionary taxes) or expenditure restraint that may be required to maintain macroeconomic stability should be designed to minimize their adverse effects on the poor (Bannister and Thugge, 2001).

In effect, experience suggests that reforming domestic tax systems should be undertaken in parallel with trade reform, not necessarily delayed until afterwards, to increase credibility of the liberalization process and reduce the likelihood of a reversal. Consumption subsidies are another means of helping the poor and these are in conformity with World Trade Organization (WTO) regulations (Cagatay, 2001) (Dodd and Cattaneo, 2006).

Finally, there is no direct evidence relating trade liberalization to reductions in social spending. Evidence suggests that with political will, social spending for the poor can be protected. The East Asia crisis of 1997, which has been a shock greater than any trade reform or shock has provided evidence that with political will and careful planning, social spending can be protected. This is evidenced by Korea's large expansion of social spending in the face of the crisis, as reported by the World Bank (2001) (Winters, et al 2004).

However, there are cases where tariff reductions hindered government power to devote adequate appropriation for social spending. Rodrik (1997) argued with

others that increased openness reduces governments' abilities to raise revenue because mobile factors can no longer be taxed.

Hence, the question whether trade liberalization restricts governments' ability in developing countries to manage spending and taxation in a way that impacts poverty remains open to further investigation.

In this respect, we have to consider that among the features of the poor is their low ability to bear risk, because an adverse event has such dire consequences. The poor may forego opportunities to raise average incomes precisely because they could not bear the higher risk of failure that accompany them. Thus they might suffer the adverse effects of a reform - e.g. higher consumption prices – without the compensating benefits of higher average earnings and hence be losers overall. In addition, if a reform makes it more difficult for the poor to continue their traditional insulation strategies, it may increase their vulnerability to poverty even if it increases average incomes (Winters, 2001).

The Investment Climate

Investment is considered an important channel through which trade could impact the poor. Trade openness lowers the cost of capital, making investment more efficient, thus increasing foreign direct investment (FDI) flows. FDI would establish new businesses and industries within a country, creating employment opportunities including the poor and increasing the overall level of productivity and growth. Accordingly, international trade cannot help to reduce poverty in countries where the level and efficiency of investment are not adequate to support sustained economic growth (UNCTAD, 2004).

Alternatively put, to ensure FDI sustainability, FDI requires structural and institutional reform that would create a conducive investment environment and not simply trade reform.

The question remains to what degree is the poor participating or empowered. This requires more analysis and understanding to the complementary policies that could effectuate the positive impact of trade policy on the poor?

Section Three: Complementary Policies

The issue of trade policy and poverty is very contentious in the economic literature. As pointed out by Winter (2001), poverty is not directly the result of international trade, it is rather a reflection of some conditions and situations which include, but not limited to, low earning power, few assets, poor access to communal resources, poor health and education, powerlessness and vulnerability. Hence, the relation between trade policy and poverty should be studied carefully through the former's impact on poverty determinants (Omoke, 2007).

In other words, poverty reduction requires at the outset identifying constraints facing the poor and limiting their abilities to participate and tap opportunities offered by trade liberalization. In this respect, there are some complementary policies that have to be adopted, parallel or even pre trade liberalization to empower the poor to reap the potential benefits and ease costs of trade liberalization.

Among the most important policies –often mentioned- are the following:

1. Infrastructure Development.

The provision of adequate infrastructure facilities is a prerequisite to reap the potential benefits of trade liberalization. Improving transportation networks, for instance, would allow the poor better access to the principal markets for their products, and benefit accordingly from opportunities that might develop as a result of trade liberalization. China and Indonesia have been cited among the most successful examples of poverty reduction in the last 30–40 years. In both cases, one of the keys to success has been the dissemination of agricultural technology through extension services, which proved to be critical to ensuring that growth benefited the poor in rural areas (McCulloh, 2005).

In other countries, however, potential opportunities for poor producers to benefit from a more open trading regime have been foregone due to lack of appropriate infrastructure. In both Zimbabwe and Zambia, for example, remote farmers found their opportunities constrained by an inability to reach major market centers, meanwhile, in the same way, many of the benefits of relaxed retailing regulations and the availability of new and/or cheaper goods have been confined to urban areas (Winters, 2000a) (CUTS, 2008).

2. Development of Market Institutions.

Among the critical issues that limit the impacts of trade liberalization on poverty alleviation is the mal functioning of markets. The poor frequently seem unable to attain the economic mass required for the establishment of markets that once established may be viable.

Trade liberalization needs to be accompanied by market monitoring to trace instances of market failure. Encouraging the development of markets involves their deregulation and the removal of monopolies (such as state trading monopolies) that could adversely affect the poor or prevent them from reaping the benefits of trade liberalization (Duncan and Quang, 2003).

Policy should aim at the creation of markets as institutions, not the ongoing subsidization of market activity. Part of facilitating the poor's participation in markets might be finding means to allow them to combine very small consignments of inputs or outputs into reasonably sized bundles that help reducing transactions costs⁵.

3. Labor Mobility and Training

Rigidities in labor markets make it difficult for the poor to move into other occupations, take advantage of new market opportunities and minimize the costs of trade liberalization. For instance, in Peru in the 1980s, a trade reform failed to generate any supply response because of severe labor market imperfection. Labor legislation prohibited firms to dismiss labor, close plants or even divert to other activities. This led to many bankruptcies, exacerbating foreign exchange and financial crises (Hoekman et al, 2002).

Labour mobility is a key factor in spreading the benefits of increasing labour demand. If markets are segmented for cultural or geographical reasons, breaking

⁵ A successful example of this kind of policy is horticulture in Zimbabwe . Whilst horticulture is relatively underdeveloped in most of the smallholder areas, an increasing number of resettled and communal households are now becoming involved as producers of the main crops. This has primarily been the result of 'Outgrower' schemes and the sourcing or subcontracting by the large-scale commercial farms. The Horticultural Promotion Council (HPC) estimates that around 3,000 small scale farmers are now growing for export on a contract basis, accounting for approximately 10% of Zimbabwe's exports. The HPC established the Small-scale Linkage Programme in January 1999, designed to provide communal and resettled farmers with the knowledge and skills to produce high-value, out -of-season export crops (Winters, 2000a).

down these barriers through information and facilitating physical mobility are essential. Also, worker training and other forms of assistance can help the poor who lose jobs in sectors harmed by trade liberalization to seek jobs in other sectors that flourish as a result.

In addition, reforms which increase labor mobility in the formal sector can have a powerful effect on reducing poverty when combined with trade liberalization by opening up additional jobs in the formal sector for workers previously in the informal sector.

As evidenced from China's experience, greater educational attainment strongly facilitates mobility from agriculture to non-agriculture, often an avenue for poverty reduction. One additional year of schooling was found to boost a worker's chance of finding non-farm employment by 14 percent (McCulloh, 2005).

Similarly, regulations on business expansion and labour recruitment could curtail the willingness of existing firms to grow in response to trade liberalization⁶.

Property rights for land (and water) are also important for taking advantage of export opportunities that may be beneficial to the poor. For example, Egypt could largely produce labor-intensive crops (fruits and vegetables) for export to the EU, as is done in other Mediterranean countries, and the rural poor could gain significantly (Barres and Valdes, 2000); but because of improper development land and water management policies, the economy has not taken full advantage of this opportunity and continues to grow traditional crops (Hoekmam et al., 2002) (Bird, 2004).

⁶ A success story of business domestic de-regulation is the growth of maize hammer milling in Zimbabwe. Following such domestic deregulation, 3 500 new hammer mills have opened up since liberalization, mainly in the rural areas, and the share of hammer millers in total maize milling has increased to almost 80% (these mills are mechanically simple and can be used by unskilled labour). They provide quality maize meal products to nearby customers in the poor communities. Hammer mills were estimated to employ 7,512 permanent workers (751 in urban areas); including casual workers, the sector employs a total of 10,000 workers; and if hammer mills in commercial farming areas are included, the total increases to 12–13,000 workers (Winters, 2000a).

4. Credit Markets

Lack of credit facilities in general, hampers development that could be induced by trade liberalization. For example, establishing informal businesses in areas such as trading may require more capital than the poor's ability.

Developing credit markets is important for facilitating access of poor farmers to necessary imported inputs to stimulate market activities.

5. Social Safety Nets:

Even the best-designed trade reform will create winners and losers. In order to mitigate the possible adverse effects of transitory, short-term adjustment costs on the poor, developing countries need to have well-functioning social safety nets to ease the tension between implementing trade reforms and alleviating poverty. They also need to quantify the budgetary costs of offsetting some of these adverse effects⁷

However, it is argued that -given substantial long-term benefits of trade reforms- the absence of appropriate safety-net policies should not unduly delay trade liberalization, because the sequencing and phasing of reforms can be designed to mitigate the transitional costs for the poor (Bannister and Thugge, 2001) (Winters, 2001)

Section Four: The Case of Egypt

Trade Liberalization:

Egypt's trade liberalization process has undergone two main waves. The first one took place in the early nineties enacting reform policies in many fields through the Economic Reform and Structural Adjustment Program (ERSAP) advocated by the World Bank and the IMF. Several procedures were taken to effectuate such policies, among these were the privatization of many state owned companies and the substantial decrease in the tariff rates (decreased from 110 % at the end of the eighties to reach 40 % at the end of nineties).

⁷ Mexico's PROGRESA (an initiative by the Mexican government targeted at the rural poor to develop their human capital by paying families to send children to school and regularly see health care providers) is a good example for targeted compensation for losers to ensure that the benefits from reform are broadly shared (McCulloh, 2005).

The second wave began in 2004, with two fold objectives: to introduce further reductions in tariff rates and rectify distortions in the current tariff structure; and to limit the number of products subject to non-tariff barriers (NTBs). Both nominal and effective protection declined for almost all manufacturing sectors after the implementation of the 2004 reform. The tariff cuts decision was to decrease the average rate from 14.6 % to 9 %, which has been much less than the 1991 and 1995 averages of 42% and 25 %, respectively. Tariff dispersion also decreased from 27 tariff brackets to only 6 with the aim of simplifying procedures, minimizing tariff evasion, and curbing incidence of corruption. Moreover, tariff lines were reduced from 8000 to 6000 which also supported the simplification of procedures. In addition, all customs service fees and charges on imports had been eliminated in 2004 (Hendi and Zaki, 2010).

Egypt had also harmonized its mandatory standards with international norms; established a coordination mechanism for all governmental bodies responsible for standards and conformity assessment to address non-transparency, and ensure that these standards were consistent with its TBT and SPS obligations. To facilitate inspection procedures, Egypt recognized inspection certificates from outside accredited agencies; and worked on the accreditation of Egyptian laboratories according to ISO standards and guidelines, in addition to implementing regulations to reduce the frequency of inspections on imported manufactured products (WTO, 2005).

Regarding trade procedures, a new one-stop shop was launched in 2008 to ease trade transactions at Egyptian ports, and cut the time of import process by seven days and that of exports by five days.

Furthermore, since mid-1990s, Egypt has been a member in many trade agreements, such as the GAFTA and COMESA. Also, in 2004 Egypt engaged in a partnership with the EU, in addition to the QIZ protocol easing Egypt's access to US market for textiles. In 2007, other 3 agreements were concluded, namely, Aghadeer, the Free Trade Area with Turkey and the European free trade area with Switzerland, Iceland, Norway and Leshtenshtien, and finally, in August 2010, Egypt has signed a free trade agreement with the MERCOSUR for trade

liberalization among its members within ten years, providing free access to Egyptian exports.

In Practice:

However, in practice, most of the expected benefits of trade liberalization did not materialize, at least not to a satisfactory level. Despite the fact that Egypt has a fairly well developed transport infrastructure, good maritime connectivity, related services and a relatively good quality of roads and importing goods is not costly, importers raise concerns about the efficiency of customs and other border agencies pointing out to the fact that bureaucracy and transaction length are significant impediments to trade. According to the Enabling Trade Index issued by the World Economic Forum (2008), Egypt has been ranked a low of 87th amongst 118 countries for the ease of getting goods across the border⁸. A ranking that raises worries about the efficiency of trade procedures in Egypt, especially that the cost of non-facilitation is very high, estimated of 2% to 15% of the traded goods value, according to OECD (2003).

In general, Egypt has been relatively restrictive compared to other (MENAP) oil importing countries (Montiel, 2010) (Zaki, 2011).

The credibility of trade liberalization in Egypt is further questioned due to the government implementation of the following policies:

1. The imposition of a sales tax of 10% on imported goods including machinery despite tariff reduction, previously mentioned.
2. The application of many NTBs to ban imports for several reasons: economic, environmental, health, safety, sanitary, and phytosanitary reasons. Several imported products were subject to mandatory quality control such as short staple cotton, steel, poultry and meat...etc.

⁸ This index determines the aspects that enable trade and breaks the enablers into four areas, or sub indices: (1) market access, (2) border administration, (3) transport and communications infrastructure, and (4) the business environment. It is worth noting that border administration indices show that Egypt is not well positioned neither for efficiency of customs administration (84th) nor for transparency of border administration (71th). Efficiency of exports and imports is located in a middle position (49th).

3. The limitation of export subsidies not exceeding L.E. 3.2 billion in 2010/2011, compared to petroleum substances subsidy L.E. 67 billion (MoP, 2010/2011).
4. Despite, Egypt's concluding of many regional trade agreements, these agreements were not very effective in practice. GAFTA was criticized for being just a form of shallow integration and hindered by many economic, political and institutional obstacles and the COMESA for being faced with bureaucracy and infrastructure problems. Also, Egypt's share of exports and imports to EU has declined from 1995 to 2008.

Trade Liberalization and Poverty:

The impact of trade liberalization on poverty has usually been studied and analyzed through the former's impact on growth which in turn reflects on poverty reduction.

However, the Egyptian case indicates that the achievement of high growth rates did not help much in poverty reduction. The volume of trade grew from US \$23.5 billion in 200/01 to US \$75.5 billion in 2008/09. Meanwhile, real GDP growth rates rose from 3.5% to 4.7% throughout the same period, reaching a peak of 7% in both 2006/07 and 2007/08. In contrast, poverty rates jumped from 16.7 % in 1999/2000 to 19.6% in 2004/2005 and then to 22% in 2008 (table 1).

Table (1)

Trade volume, GDP and Poverty Growth Rates

Year	Trade Volume (US\$ billion)	Trade Growth Rate (%)	GDP Growth Rates (%)	Poverty Rates (%)
1999/2000				16.7
2000/01	23.5		3.5	
2001/02	21.8	-7.5	3.2	
2002/03	23.0	5.8	3.2	
2003/04	28.7	24.8	4.1	
2004/05	38.0	32.3	4.5	19.6
2005/06	48.9	28.6	6.8	
2006/07	60.3	23.37	7.1	

2007/08	82.1	36.13	7.2	
2008/09	75.5	-8.05	4.7	22 (2008)
2009/2010	72.9	-3.5	5.1	

Sources: Ministry of Planning and Ministry of Finance, Annual Reports and (EL Laithy, 2009).

More specifically, Egypt's GDP growth structure has revealed that the bulk of GDP growth is attributable to consumption followed by investment, reflecting the domestic market ability to compensate for the impact of external shocks and hence the vulnerability that accompanies trade openness and liberalization. As illustrated in table (2), net export reflects either negative or minor positive (with the exception of the year of the international financial crisis 2008/09) contribution to GDP growth rate, given the voluminous of Egypt's imports and the continuous growing trade deficit (table 3).

Table (2)
Sources of Economic Growth

	2004/05	2005/06	2006/07	2007/08	2008/09	2009/2010	2010/2011
GDP Growth Rates	4.9	6.8	7.1	7.2	4.7	5.1	1.8
Final Consumption	2.9	4.1	5.0	4.4	4.1	3.5	4
Investment	1.5	2.3	4.5	3.2	-2.0	1.5	-0.9
Net Exports Changes	0.5	0.4	-2.4	-0.4	2.6	0.1	-1.3

Source: Ministry of Planning, Annual Reports

It is quite apparent from above that -on one side- trade does not attribute directly to GDP growth and that the latter has not been reflected in poverty alleviation. Hence, trade liberalization, within this context may appear irrelevant to the poverty issue.

Table (3)
Trade Balance

Year	Trade Balance	Trade Balance/ GDP
2000/01	-9.36	-9.7

2001/02	-7.52	-8.8
2002/03	-6.62	-8.2
2003/04	-7.83	-10.0
2004/05	-10.36	-11.6
2005/06	-11.99	-11.2
2006/07	-16.29	-12.5
2007/08	-23.42	-14.4
2008/09	-25.17	-13.3
2009/10	-25.12	-11.5
2010/11	-23.78	

Source: Ministry of Planning (various issues)

The inability of trade liberalization to participate satisfactory in poverty reduction, could be elaborated further by considering the trade structure and regulations as well as trade channels.

Considering first, Egypt's exports, the following could be pinpointed:

1. The structure of Egypt's exports reveals that petroleum exports accounted on average for about 47% of total exports during the period (2005/06-2009/2010) (MoP, 2010/2011) (CBE, august 2011); and given the capital intensity of these exports, the employment implication of export expansion resulting from trade liberalization has been quite limited; in contrast to many developing countries where the majority of exports tends to be concentrated on labour intensive products.
2. Within trade liberalization, Egypt has been exporting some goods of critical importance, at unfavourable terms of trade. The most striking example is natural gas exports, which has been sold under long term supply contracts (20 years) at very low fixed price to Europe and Middle Eastern countries⁹. Apart from foregone export earnings and quick depletion of natural resources, this course of action has exerted adverse impact on the livelihood of citizens, particularly the poor household whose houses are still not connected to natural gas pipelines and who had to resort to more expensive energy supply sources, in addition to the shortage of procurement of natural

⁹ Ranging from 0.75 cents to US\$ 3 whereas the international price ranges from US\$ 13 to 14 (the average price in the Mediterranean area has been US\$12.8 last month).

gas for fertilizers production which is a main input for the agriculture sector and hence the livelihood of rural population.

3. The exportation of some basic agricultural products, particularly food commodities like rice has been depriving the poor from satisfying main nutritional items at reasonable prices. Although the government resorted to export bans during periods of severe shortage of rice production, in order to satisfy increasing domestic demand, this course of action did not benefit the poor in terms of easy access or lower prices due to market inefficiencies arising from producers and traders unfair practices.
4. Trade statistics reveal modest growth of agriculture exports relative to manufacturing exports, the former growing by less than 10%, which is less than half the corresponding growth rate of the latter. This has a direct negative impact on the poor since the majority live in rural areas engaged in one way or another in agricultural activities¹⁰(MoP, 2009/2010).
5. The cost of exports transactions is relatively high in Egypt hindering export growth due to several institutional constraints. For instance, in Egypt the cost of export (per container) is US \$ 613 in 2012, compared to US \$ 577 in the case of Morocco. Globally, Egypt stands at 64 among 183 economies on the ease of trading across borders, after UAE, Saudi Arabia and Jordan (Doing Business Report, 2012).

Turning to **Imports**, although Egypt has eliminated import quotas, it has imposed NTBs¹¹ on certain goods, which creates or preserves some degree of monopoly power under different claims such as safety or hygienic reasons. Steel products, fire extinguishers are just examples to cite. Such market protection measures typically favoring dominant producers enjoying significant market shares are at the expense of consumers welfare and hit the poor either directly in case of food items and basic services or indirectly in case of intermediate goods such as steel bars for the construction of shelters.

¹⁰ There is a big disparity between urban and rural poverty rates, for instance, it represents 9.2% and 22.1% for 1999/2000 and 10.1% and 26.8% for 2004/05 (according to national poverty line (El Laithy, 2009).

¹¹ According to Heritage foundation, Egypt ranks 74 on trade freedom out of 178 countries, due to NTBs imposed by the government.

In case where NTBs are not adopted, still the increase in flows of imports did not imply price advantage for consumers, as market inefficiencies arising from quasi monopoly power and weak transmission mechanism may prevent the consumer – particularly the poor- from reaping the benefits if international cost advantage.

In addition, with the weak domestic regulations and the inadequate capacity building, the import penetration has led to market dumping and the closure of some labour intensive small domestic industries (the predominance of Chinese products in the Egyptian market is a good manifestation of the dumping issue threatening local producers specially of low value goods consumed by the poor).

As for inflation impact, price reduction has been often stated as one of the potential benefits of trade liberalization, whether due to cheaper imports’ penetration or decreasing cost of domestic production, or export enhancement. Yet, in the Egyptian case, inflation rate has been oscillating, but reflecting an upward rising trend in general, growing from a low level of 3.2% in 2002/03 to 11% in 2006/07 and then to 15.5% in 2008/09, although declining afterwards still the prevailing rate is above 11% implying a high burden on poor families as the inflationary trend is partly due to the rising cost of imported food items, especially wheat, maize and vegetable oil (table 4).

Table (4)
CPI (Urban) (2002-2011)

Year	Inflation rate
2002/03	3.2
2003/04	10.4
2004/05	11.4
2005/06	4.2
2006/07	10.9
2007/08	11.7
2008/09	15.5
2009/10	11.5
2010/2011	12.2

Source: Ministry of Planning, Annual Reports

As for employment generation, trade liberalization is expected to increase job opportunities in potential sectors, attenuating thereby the unemployment problem. However, this did not materialize in the Egyptian case, as CAPMAS labour force sample survey reveals growing trend in unemployment rates from 8% in 1999 to 11.2% in 2005 and then to 12.4% in 2012.

Naturally, this result cannot be attributed to trade policy alone, even with the relatively limited share of labour intensive exports, as it is a manifestation to the existence of many structural problems in the Egyptian economy, such as the mismatch between education output and business sector's needs for workforce, labour market rigidity, insufficient and inadequate training¹².

As for trade –investment relationship, trade liberalization opens new vistas for investment by securing better business climate; but the extent of this investment impact on employment generation or poverty alleviation would depend to a large extent on the type of investment induced by trade freeing.

This impact is relatively limited in the case of Egypt as investment tends to focus on capital intensive industries with low spill overs. Petroleum and ICT sectors accounted for almost 40% of total investment in 2011/2012 while agriculture activities share was of meager magnitude (about 2% of total investment) (MoP, 2011/12).

Finally, concerning government expenditure, it has been claimed that trade liberalization would reduce trade revenues, which in turn would limit governments' ability to spend on social programs –mainly- targeting the poor. This argument is not confirmed in the Egyptian case. Trade revenues account for a small proportion of total government revenue (around 9 % on average) during the

¹² In the textiles and garment sector, for instance –which is a driving industry in Egypt with high labour intensity- reliance on foreign workers has been increasing in the past few years. In 2009, more than 20000 foreign workers joined the industry accounting for 13% of the total Egyptian labour force in the industry (The Egyptian Report for Investment 2009/2010).

period (2006/07-2009/2010) relative to taxes on goods and services for instance representing 37% during the same period.

In addition, government expenditure on subsidies, grants and social benefits has been accentuated over time from 18.4% in 2004/05 to 28.1% in 2009/2010, as a percentage of total expenditure. In absolute terms, the increase was from almost L.E. 69 billion to L.E. 127 billion through the period 2005/06 to 2008/09. In particular, subsidies to food have doubled from L.E. 16.8 billion to L.E. 33.7 billion in 2009/2010 (MoF, 2011), (CBE, 2011). Such increases took place regardless of the rise of international price of imported items in the consumer subsidy baskets¹³

According to the previous analysis, the relation between Egypt's trade liberalization and poverty, through growth, is dubious. Trade did not tangibly contribute to growth and the latter did not display a trickle-down effect. This could be explained due to the composition of exports (capital intensive, concentrated among a small group of beneficiaries, basic goods competing with local demand), NTBs on some imports consolidating status of monopoly power, modest job creation aggravated by labour market rigidity, domestic inefficiencies minimizing the pass through of cheaper prices to benefit the poor.

One should emphasize the role of developing infrastructure, easing access to finance, overcoming market inefficiencies and labour market flexibility, all of which would empower the poor to benefit from opportunities created due to trade liberalization. Also, the integration and consistency of trade policy with all macroeconomic policies is a necessity to ensure real progress in the alleviation of the poverty problem.

¹³ For example, expanding bread subsidies to L.E. 21 billion during 2009/2010 in light of rising global wheat prices. On annual basis, Egypt imports 7.6 million tons, which is equivalent to 60 per cent of local consumption (MoP, socio-economic development plan 2007/08-20011/12).

Conclusion:

Trade liberalization alone is not a cure to the poverty problem. The elimination of restrictions to trade should be thought of within an integrated scheme to combat poverty. All positive impact of trade in terms of higher productivity, employment generation and improved terms of trade and resource allocation, will not manifest in full, unless accompanied with the effectuation of relevant channels of trade liberalization (market, enterprise, government and investment climate), and provided that trade liberalization is consolidated by complementary policies related to infrastructure and market institutions development, labour mobility, adequate credit facilities and social safety nets; all of which are conceived as indispensable means to empower the poor to benefit from opportunities generated through trade liberalization. In this context, the integration and consistency of trade policy with all macroeconomic policies becomes a necessity to guarantee real advancement towards the poverty alleviation.

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