Linkages between trade and poverty

Comments on paper by Martin Cicowiez and Adriana Conconi
Trade and pro-poor growth: A preliminary survey

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1.- Introduction

The debate on the linkages between trade and growth, as well as on mechanisms that can help to create better conditions in order to increase employment and reduce poverty and inequality, is a longstanding one. Bhagwati and Srinivasan (2003, 2002) recalled that Sir Dennis Robertson (1940) described trade as an "engine of growth" many years ago. Adam Smith (1937) also discussed progress and the improvement of labour conditions. In other words, the idea that trade will promote growth, and growth will reduce poverty, has deep roots.

In the twenty-first century, however, despite many factors that might be thought to contribute to a dynamic of poverty reduction through growth —the advanced state of globalization, patently greater trade openness, strong interdependence between trade and finances and increasing numbers of people enjoying the benefits of the market— it cannot be said that rising standards of living are the general rule for large numbers of citizens in many countries, especially not for those living in rural areas. Not everyone enjoys higher standards of living, because certain people and social groups have been left behind as progress marches on. Tensions between rich and poor persist in markets and society.

¹ The views expressed in this document are those of the author and do not necessarily reflect the views of the institutions with which the author is associated.
Poverty reduction is one of the main concerns of every government and policymaker around the world, and is now at the heart of development strategy efforts, especially in developing countries. These efforts are galvanized by the urgency of achieving the first Millennium Development Goal: “Eradicate extreme poverty and hunger”.

There is much that economists and economic policymakers do not yet know. We need instances, such as meetings with policymakers, in which to build up knowledge, to receive feedback and also to explain, with due humility, that the problem of poverty is not a direct product of international trade, but can be worsened when the conditions needed to capitalize on the advantages that economic openness can provide are absent or insufficient. Among others, such shortcomings include: under-endowment of human capital and skilled labour, poor physical infrastructure, minority social groups’ lack of power and influence in society, and vulnerability.

This state of affairs is its own justification for exercises like the one undertaken by Cicowiez and Conconi (2007), and for the fruitful initiative of the Inter-American Development Bank (IDB) and the Poverty and Economic Policy Network (PEP), which aim to develop a better understanding of the causes and consequences of poverty. It also constitutes a motivation to stretch our imaginations to devise new policies and ideas to help governments and societies to reduce poverty and inequality, in what may be the greatest public-policy challenge of our time.

In order to comment on the Cicowiez and Conconi paper (2007) and to frame my own discussion, in section 2 I will give a brief executive summary of the work and, in section 3, I will focus on its main contributions. In the fourth part, I will offer some suggestions to enhance the work, though not without first emphasizing that this is a diligent and very well organized piece of work, which will be of great value. Lastly, I will close with some conclusions.
2.- Executive Summary: Trade and pro-poor growth: A preliminary survey.

The work of our colleagues sheds considerable light on the relationship between trade and pro-poor growth. Based on a review of almost 60 papers on the subject, it concludes that much work remains to be done in the future, mainly because research into the impact of trade and growth has returned ambiguous findings, depending on the countries used for the analysis. For example, it is widely accepted that liberalization has been beneficial for Chile in terms of economic growth, but the same cannot be said for Mexico (Puyana, 2003). The explanation for these dissimilar results would seem to lie in the differences between possible determinants of causality, some of which are: (a) access to cheaper imports of capital and intermediate goods; (b) successful export promotion policies; (c) a better competitive environment; (d) the presence and efficiency of foreign direct investment (FDI); (e) the existence of bundles of human capital. The relative importance of these factors will clearly depend on the specific traits of each country. In general, the paper follows the theoretically accepted idea that “poverty, growth and trade policy are dependent on each other”.

The survey concludes with a list of seven points on which the literature shows a consensus. These are: (i) in the long run, growth is a key to reducing poverty but does not, in principle, seem to affect inequality; (ii) in order to be pro-poor, growth needs to be accompanied by progressive changes in distribution; (iii) high initial inequality acts as a brake on poverty reduction; (iv) in itself, poverty is likely to be a barrier to poverty reduction; (v) asset inequality seems to predict lower future growth rates; (vi) education, infrastructure and macroeconomic stability seem to positively affect both growth and the distribution of income; and (vii) the extent to which governments should focus on growth or distributional change to achieve poverty reduction depends on individual country conditions, particularly levels of economic development and initial inequality, as well as society’s level of tolerance for inequality.
3.- Main contributions

In this section I would like to highlight three of the main factors which, in my opinion, make this piece of work an important tool for policymakers and trade economists.

- **Understanding of how to recognize pro-poor growth.** Section 2 of the paper gives a very good definition of pro-poor growth: “any increase in GDP that reduces poverty and inequality”, both in absolute terms. A good combination from a policymaker’s point of view would be: “growth with a progressive distributional change”.

- **An interesting review of the theoretical and empirical literature that links trade liberalization and economic growth, growth and inequality and growth and poverty.** As well as giving an account of the mainstream literature and manuscripts, section 3 of the paper sheds light on the weaknesses of some empirical works: (a) endogeneity problems; (b) the weakness of measurements due to frequent correlation between control variables (trade openness and macroeconomic stability variables in some cases); (c) omission of some control variables, and so forth. Nevertheless, I would like to note here that Rodrik’s (2001) criticism and skepticism that trade openness will be good for growth is broadly refuted by Srinivasan and Bhagwati (2001), Bhagwati and Srinivasan (2002, 2003), in defense of A. Krueger (1998). This works should also be analyzed in order to do justice to academia.

- **The paper also examines the type of policies a country should pursue in order to apply a successful poverty reduction strategy.** I will try to summarize some intersections the paper finds in the empirical literature based on cross-country studies and also on specific case studies (China, India, Morocco and Brazil): (a) better education impacts positively on growth
and inequality, with primary and secondary schooling having a even stronger effect than higher education; (b) lower inflation levels reduce levels of inequality; (c) investment in better infrastructure (in quantity and quality) contributes to increasing growth and reducing inequality.2

In the following section some ideas that would benefit from further development in the paper, in order to improve the concluding remarks section and thus enhance the understanding of readers and, most importantly, the perception of policymakers as regards the policy effects of trade and trade reforms and its links with growth, poverty and inequality.

4.- Recommendations to improve the survey

I would suggest changing the slant of the concluding section (section 5) to include some policy implications as well. The section might thus be called “Concluding remarks and policy implications”. Below are my main observations on some of the items and suggestions to enhance the quality of the work and sharpen its focus towards policymakers:

- **Trade liberalization is not the same as development strategy.** It is crucial that policymakers be clear about this difference. For that reason, this subject must be carefully handled, because policymakers or government officials in developing countries could confuse the two, and we know that they are not the same. The paper contains several arguments that could be used to emphasize this point, especially in section 3.1.a in the analysis of different approaches to relations between trade liberalization and economic growth (neoclassical, endogenous growth and the new institutional economics approach).

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2 Other possible policies with more ambiguous results include: more trade openness (unilateral signature of free trade agreements and so on), reduction of government spending and better rule of law. See section 4 of the paper for a more detailed analysis of this point.
• **Trade liberalization must be accompanied by active public policies** to mitigate its potential negative effects, enhance positive impacts and latch on to the heightened dynamic opportunities to link trade with growth and, from there, to seek out the best combination to improve income distribution and thereby reduce poverty — in other worlds, to make trade and growth truly pro-poor. In other words, as the paper suggests, “trade liberalization almost certainly requires combination with other appropriate policies as well”.

• In my opinion, section 4.2 on **country case studies could be expanded to include other cases that are more representative for small and medium-sized developing countries**. India and China are good references for large countries, and it is understandable that the researchers should have chosen them as cases in which poverty is so widespread. Indeed, a vast majority of the world’s poor live in the rural areas of those two countries. Both countries achieved significant reductions in poverty during 1980-2000 when they grew rapidly (Benjamin, et al (2007); Ravallion and Chen, (2004); Bhagwati and Srinivasan (2003); Bhagwati; 1993; Zhang, 1993). A good way to fill this gap (in my view) would be to define a set of benchmark countries from Latin America, Africa and Asia (for example: Chile, Costa Rica, Bolivia, Ghana, Tunisia, Uganda, Vietnam, and so forth). Useful references for this are the work of BooySEN et al (2007), Sahn and Stifel (2000); Worldbank, (2005) and PovertyNet, the section devoted to poverty on the World Bank website (www.worldbank.org/poverty/).

• I would like to encourage the authors to **think a little more about cases of countries mired in the “poverty trap”, with high levels of extreme poverty**. These countries are undoubtedly in need of big push strategies and specific policy suggestions are merited in these cases. One suggestion, for example, is that they should be allowed to benefit from cuts in agricultural subsidies in the framework of the Doha round of trade talks in the World Trade Organization. This discussion falls somewhat outside the
main subject of the paper, however. In a preliminary version, section 5 looked at the subject of “Poverty and World Trade Negotiations”, which would be a good starting point for bringing in this particular discussion.

- Similarly, **countries at risk from the poverty trap and that are moving towards greater trade openness should be careful to sequence liberalization processes to avoid damaging sensitive sectors that have not yet had the opportunity to reconvert**. It is crucial for negotiators at the bilateral and multilateral levels to grasp this, because it is a key to improving the relative position of their respective countries. Openness should not be construed as shock-therapy for these countries. Policymakers must understand that the optimum speed of reform is not necessarily the maximum speed. McCulloch et al (2001) gives an insightful analysis of how trade liberalization must be institutionally managed to ensure that the poor are not hurt in the process.

- An important message for policymakers that should perhaps be explored in greater depth has to do with price transmission mechanisms, since these are often very weak in rural areas\(^3\). Openness and trade liberalization might not, therefore, have the desired effects. They might not, indeed, have any effect at all on rural areas. Nicita (2004, 2005) conclude that in Mexico, only a small fraction of international prices changes due to the Doha Round of trade negotiations would be almost zero in rural areas of Mexico. In these particular cases, public policymakers should provide the means for price improvements to bring real benefits for the poor, otherwise inequality and disparities could actually increase, as poverty worsens in areas that are isolated from the markets.

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\(^3\) Nicita (2004) finds that price transmission decreases as distance to the border increases. Schuschny et al (2007) explain that urban areas are more sensible to changes in prices at the border than rural areas.
• **Also worth considering with a view to improving the research would be a review of ex-post evaluations of the employment effects of preferential trade agreements.** This is an important issue for policymakers, because the employment implications of globalization have been used as a basis to question trade openness. Also, there is empirical evidence that in Brazil, Chile and Colombia, about three quarters of net employment creation in the 1990s was driven by domestic demand rather than by exports (Gutierrez 2004). These trends provide incentives to look further at the employment effects of trade liberalization through free trade agreements. There are a number of questions to address in this type of research: How does employment operate as a conduit for poverty reduction? Does trade liberalization create more jobs than it destroys? Should the emphasis be on creating unskilled jobs or more highly skilled ones? Literature addressing this topic may be found in Gutierrez (2005), Berrentoni and Cicowiez (2005), Botero (2005), Gutierrez (2004), and Marqués and Pagés (1997).

• I would like to have seen something in the paper on the research carried out by ECLAC on the relationship between growth and poverty. Colleagues at ECLAC used the most recent household surveys in the Latin American countries to calculate the GDP growth that would be needed to achieve the first target of the Millennium Development Goals, to “halve, between 1990 and 2015, the proportion of people whose income is less than one dollar a day”. The growth in per capita GDP required in Latin America to achieve that target is 2.9% per year. This rate is equivalent to total GDP growth of 4.3% per year. But in the scenario of an improvement in income distribution, extreme poverty could be halved with a per capita GDP growth rate of only 2.1%, not 2.9%. ECLAC studies have also found that an improvement in income distribution could enhance the effect of economic growth on poverty reduction. They estimate that the regional growth rate needed to achieve the extreme poverty reduction target would decrease by approximately 0.2
percentage points for each percentage point reduction in the Gini coefficient (ECLAC, 2002; ECLAC, 2005).

5.- Conclusion

My perception is that the paper is written for policymakers and did a good job of summarizing the best and more recent literature, but its concluding section needs to be more proactive to give policymakers more ideas and suggest possible policies to apply. Admittedly, we still do not know enough about the potential impact of income inequality and redistribution on growth, but we could take a more optimistic approach to giving policymakers the arguments they need to create a consensus among the population. We need to give them tools to create awareness of the need for greater solidarity in the private sector —not only in governments— because business also has a decisive contribution to make in forming a pro-growth and pro-poor environment. Corporate social responsibility should be analyzed in this regard.

As a concluding remark, I would like to emphasize how little we really know because of the ambiguity in the empirical literature and —perhaps its main cause— the added complication of obtaining data that are comparable among countries. Nevertheless, we can strive to improve our understanding at the regional level and pool our efforts to bridge some of the remaining gaps in our knowledge. Lastly, I would like to recommend reading and using Martín’s and Adriana’s work, and thank them most sincerely for confiding to me the reading of their preliminary version.
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