

## **WHY TRADE MATTERS FOR THE POOR**

**Judith M. Dean\***

**International Economist  
Research Division  
Office of Economics  
US International Trade Commission**

**Prepared for the 20th Anniversary Conference  
Association of Christian Economists  
"Economists, Practitioners, and the Attack on Poverty: toward Christian Collaboration"  
Jan. 5-6, 2003  
Washington, DC**

\*Dean is with the Office of Economics of the U.S. International Trade Commission. Office of Economics working papers are the result of the ongoing professional research of USITC Staff and are solely meant to represent the opinions and professional research of the individual author. These papers are not meant to represent in any way the views of the U.S. International Trade Commission or any of its individual Commissioners. Working papers are circulated to promote the active exchange of ideas between USITC Staff and recognized experts outside the USITC, and to promote professional development of Office staff by encouraging outside professional critique of staff research.

## Why Trade Matters for the Poor

*“International trade can play a major role in the promotion of economic development and the alleviation of poverty. We recognize the need for all our peoples to benefit from the increased opportunities and welfare gains that the multilateral trading system generates... We recognize the particular vulnerability of the least-developed countries and the special structural difficulties they face in the global economy. We are committed to addressing the marginalization of least-developed countries in international trade and to improving their effective participation in the multilateral trading system.”*

***The Doha WTO Ministerial Declaration (2001), par. 2,3.***

*“World trade has the potential to act as a powerful motor for the reduction of poverty, as well as for economic growth, but that potential is being lost. The problem is not that international trade is inherently opposed to the needs and interests of the poor, but that the rules that govern it are rigged in favour of the rich...*

*...where good policies enable poor countries and poor people to participate in markets on equitable terms, trade can act as a force for poverty reduction.”*

***Oxfam, “Rigged Rules and Double Standards” (2002), pp. 5, 47.***

In the years leading up to the new millennium, many poor countries made dramatic reductions in trade barriers. Unlike earlier periods, this liberalization was uni-directional and continual in most countries outside Africa. Reform was significant in scope and magnitude, even in countries which had long maintained high levels of protection and extensive restrictions on foreign exchange. Perhaps the most remarkable changes occurred in Latin America, where trade restrictions fell, in many countries, nearly to the levels of East Asian “tigers.” However, liberalization also began to accelerate in South Asia--especially in India and Bangladesh in the early 1990s. Within East Asia, significant reform occurred in some ASEAN members during the 1980s, and began in China and Viet Nam in the 1990s. Only in Africa was there little progress towards a liberalized trade regime (Dean, et al.,1994).

Surprisingly, Oxfam and the WTO are singing a similar song regarding freer trade. Granted a few of Oxfam’s verses are not found in the WTO’s songbook, and vice versa. But the main theme is the same. Trade is seen as a powerful force for growth and poverty reduction, and developing countries need to be able to effectively participate in it. Both institutions argue that developing countries have been impeded from fully taking advantages of the benefits of trade, and that this needs to change. This will require reform of trade policy in both poor and rich countries, as well as changes in the WTO. But why

do these organizations both believe trade can help alleviate poverty?

The causes of poverty are multiple and complex. However, a few factors appear to be fundamental to both understanding the origins of poverty and finding effective solutions: lack of income and assets, voicelessness, and vulnerability to shocks (World Bank, 2000). Most of the world's poor still live in rural areas and are mainly involved in agriculture. They own few physical or human assets (land, skills, education, good health), and the return to these assets is often low and volatile. Access to financial assets, such as savings and credit are often non-existent. Many poor countries suffer from the absence of rule of law, or corruption in law enforcement. The poor are often disproportionately the victims of usury, bribery, and indentured servitude, despite the existence of laws which prohibit these practices. In the face of adverse shocks, families with few assets also have little to sustain them. Floods, crop failures, high inflation, government collapse, job loss, and sickness, can easily push these families into dire poverty. To the extent that more open trade addresses these fundamental factors, it can reduce poverty.

The links between trade and poverty are complex and can be ambiguous (Winters, 2000). Trade liberalization generates winners and losers in the short run. It affects the poor in terms of their ability to earn income, and their ability to buy goods with that income. Thus, the impact on the poor depends critically upon where they work, what skills they have, what they consume. Clearly the implications of trade liberalization will differ across countries. However, certain common characteristics of poor households, across countries, suggest that freer trade in both developing and industrial countries should help reduce poverty.

## **I. Trade brings higher national income and faster growth**

Since the majority of the world's poor still live in the lowest income developing countries, expanding national income is critical to raising the welfare of all groups in a nation. One of the most widely agreed upon conclusions in economics is that international trade raises the overall income of a country.<sup>1</sup> There are two fundamental reasons for this welfare improvement. First, countries have access

---

<sup>1</sup>See any standard textbook on international economics.

to many goods at relatively cheaper prices than in their domestic market; they also find more profitable markets in which to sell many other goods. Second production of goods in which the country has a comparative advantage expands, while those sectors displaying comparative disadvantage shrink. Since this is a reallocation of productive factors from less efficient sectors to more efficient sectors, overall real GNP rises.

In addition, more open trade may have dynamic effects on a country's economy. Many empirical studies have posited that freer trade increases a country's growth rate by raising the productivity of a country's labor and capital (what is known as "total factor productivity" or "tfp"). The channels through which this could occur include: exposure to increased competition in the global market, access to new technology via trade in information or imitation of new products; increased foreign direct investment (FDI) which may bring new technology, economies of scale in production, as firms now sell in a global market, as well as access to cheaper imported inputs.

Using country-level data, researchers have found a large amount of evidence that more open economies do appear to grow faster. Although this work is limited by imperfect measures of trade openness, as well as lack of precision in modeling links between trade policy and growth, progress on both these problems has been made. Recent work shows that the positive effects of trade openness on growth are evident for different time periods, many different measures of trade openness, and for both industrial and developing countries. New evidence also suggests that the links between trade openness and growth may be indirect—trade liberalization inducing more investment, and thereby more growth.<sup>2</sup>

## **II. Trade liberalization in developing countries is "pro-poor"**

One of the most common features of trade restrictions across the developing world, has been their *bias against agriculture*. Import-substitution development programs entailed high trade barriers to promote the growth of capital-intensive import-competing manufacturing industries. These barriers

---

<sup>2</sup>See, for example, Wacziarg (2001), Greenaway (1998), Edwards (1998), Baldwin and Seghezza (1996), and Harrison (1996). See Rodrik and Rodriguez (1999) for a critical view of some of this empirical work.

inevitably depressed the relative price of agricultural products, reducing the returns to farmers. This was compounded by overvalued exchange rates, which kept imported inputs into manufacturing cheap, but made agricultural exports expensive in the eyes of foreign buyers. Some countries (particularly in Africa) required farmers to sell their crop through state-owned marketing boards. These monopsonies usually taxed the crop heavily, implying that farmers ultimately received a very small fraction of the world price for their crop. These practices were so common that researchers sometimes use an aggregate measure of bias against agriculture as a proxy for the trade restrictiveness of a country (Harrison, 1996). The dismantling of these trade restrictions, and foreign exchange distortions, has meant a rise in the return to agricultural production. As agriculture remains a principle means of income of many of the poor, this move toward more open trade directly addresses one of the fundamental causes of poverty.

Oxfam (2001) discusses several examples of the benefits to smallholder agriculture after reforms. After significant reductions in agricultural taxes, and rights to sell in export markets, Viet Nam shifted from a small net importer of rice to a major exporter. The widespread growth in rice production also stimulated demand for rural labor. Oxfam cites a dramatic drop in the proportion of Vietnamese below the national poverty line during this time. In Uganda, taxes on coffee exports and overvalued exchange rates had pushed many small farmers into subsistence. When Uganda removed the export taxes, moved toward a market-oriented exchange rate and removed trade barriers on agricultural inputs toward the end of the 1980s, coffee production rose. Oxfam notes a dramatic drop in the percentage of Ugandans below the national poverty line as a result. They also note that higher farm income promoted diversification in production, and improved nutrition. Crop diversification helps reduce the effects of adverse shocks faced by poor families, and better nutrition helps build up human assets. These again are fundamental factors which directly help reduce poverty.

The type of restrictive trade regime described above also embodied a *bias against low-skilled labor-intensive manufacturing*—the type of manufacturing in which many developing countries have a comparative advantage. Reductions in manufacturing trade barriers have raised the relative profitability of sectors such as textiles, clothing, electronics, shoes. Since these industries employ very low-skilled workers, are small scale, and require little infrastructure, expanded output and employment in these

sectors have meant higher incomes for many of the most vulnerable urban workers. Oxfam cites studies of Mauritius and Bangladesh, where expansion of textiles and apparel industries have significantly increased employment of low-skilled workers, many of whom are women.

In addition to the fundamental gains from trade discussed above, more open markets give a country access to a wider variety of goods. Quite often trade restraints exist against basic consumer goods such as clothing or household products, creating a *bias against low-income consumers*. Until the mid-1990's, India, effectively banned the import of all consumer good items, leading to relatively high prices and low quality for these basic items. Oxfam notes that the Vietnamese government retains very high tariffs on bicycles, supporting jobs in the local bicycle industry. However, this raises the cost so high that millions of poor families can't afford a bicycle. Since such items make up a disproportionately large share of the expenditure of poor households, the cost of such trade barriers fell more heavily on the poor. Removal of this bias is an additional source of gain for the poorer groups in developing countries. By making better quality consumer goods available at lower prices, freer trade can help raise the purchasing power of poor households.

### **III. Trade liberalization in industrial countries is "pro-poor"**

Oxfam (2001) argues, correctly, that industrial country trade policies work against the ability of developing countries to benefit from trade. First, these trade policies *damage developing country agricultural exports*. EU trade barriers and internal price supports have generated excess production for many goods which are major exports of poor countries. In addition, excess output has been dumped on global markets, significantly reducing the prices poor countries receive for these products. US internal price supports for dairy and other farm products also contribute to this problem. It is precisely these sorts of policies which prevent the benefits of freer trade from accruing to the poor. Because many of the poor in developing countries are net suppliers of agricultural products, the net effect of these barriers is a reduction in their real incomes. Removing these trade barriers and price supports will be critical for reductions in global poverty. Again singing from the same page, the WTO explicitly commits to making these issues priorities in the next WTO round. With respect to agriculture, the Doha Declaration states

that the WTO members “[commit themselves] to comprehensive negotiations aimed at: substantial improvements in market access; reductions of, with a view to phasing out, all forms of export subsidies; and substantial reductions in trade-distorting domestic support “(WTO, 2001, par. 13).

Second, *the most restrictive industrial country trade barriers are imposed on developing country products*<sup>3</sup>. Oxfam notes that the manufactured goods which face the highest (peak) tariffs in industrial countries are exactly those goods in which developing countries have a comparative advantage. This tends to inhibit growth in these developing country industries, and works against the benefits described above. Apparel is a particularly critical example, where the combination of non-tariff and tariff barriers tends to raise the average US price of a garment by about 34% (USITC, 2001).<sup>4</sup> While the non-tariff barriers on industrial country apparel imports are supposed to be removed by 2005, there is grave concern that industrial countries may back away from this commitment, leaving market access extremely limited and distorted.<sup>5</sup> With respect to non-agricultural products, the WTO Declaration commits “... to negotiations which shall aim...to reduce or as appropriate eliminate tariffs, including the reduction or elimination of tariff peaks, high tariffs, and tariff escalation, as well as non-tariff barriers, in particular on products of export interest to developing countries.” (WTO, 2001, par. 16). One estimate (cited in Oxfam, 2001) suggests developing country exports could expand by 11 percent, simply by removing the trade barriers on goods facing peak tariffs. This would clearly translate into significant expansion in employment and output in these industries in poor countries.

A less obvious, but perhaps more serious impediment to industrial country market access is anti-dumping policy. In the U.S., industries may file complaints that exporters are selling their products in the US market at “less than fair value.” The Dept. of Commerce then determines the “dumping margin,” while the USITC determines if this dumping has caused significant injury to the US industry. The WTO allows member countries to determine their own mechanisms for policing anti-dumping. Many studies have found the U.S. system pre-disposed to finding dumping. Under the present system, *developing*

---

<sup>3</sup> Early evidence of this can be found in Ray and Marvel (1984).

<sup>4</sup> This is a lower bound estimate.

<sup>5</sup> There are serious problems with Oxfam’s analysis of this issue. See Spinanger (1997) or Dean (2002).

*countries are increasingly the targets of these anti-dumping charges.* Exporters from developing countries often do not have the skilled personnel necessary to file the required evidence nor to defend themselves against these charges. The penalties can be extremely high. Oxfam cites the example of EU anti-dumping duties of 25% against bed linens from India, from 1997-2000. Even though the EU ultimately voted that these duties were unjustified, and suspended them, the damage to the Indian industry (reductions in output and employment) during these three years was significant. As of November 2002, the US had anti-dumping duties against 47 Chinese products and anti-dumping or countervailing<sup>6</sup> duties against 14 Indian products, some of which have been in place since the 1980s.

#### **IV. Trade liberalization is not a panacea**

The extent and type of trade restrictions maintained by both developing countries themselves, and by industrial countries, have increased the marginalization of poor countries from the world trading system. Dismantling these barriers should be pro-poor. However at least two caveats should be recognized. First, trade reform takes place in the context of other policies. Thus, its effects can be magnified or impeded by these other policy choices. Second, trade policy cannot, by itself, solve the poverty problem.

Potential benefits of trade may not accrue to the poor because of other policy choices made by governments. As Oxfam notes, these policy choices are not inherently linked to trade policy, and hence are avoidable. Winters (2000) cites an example used in an earlier Oxfam study which illustrates the point. In the 1990s, Zambia abolished the official purchasing monopsony for maize. However, the activity was taken over by two firms which kept purchase prices low, and did not serve remote areas. Here, lack of competition and lack of access to a market prevented benefits of maize trade from reaching farmers. In contrast, abolition of the official purchasing monopsony for cotton in Zimbabwe led to three buyers emerging, including one owned by farmers. Here, the increased competition led to higher prices for farmers. The distinction in these two cases, rested not on trade liberalization at all, but on the promotion

---

<sup>6</sup> Levied against countries which have “unfair subsidies” on their export goods.

of competition among private buyers, and access to those buyers.

The evidence presented in the *World Development Report 2000* shows quite clearly that freer trade alone cannot solve the poverty problem. While acknowledging the many difficulties in measuring poverty with any accuracy, the World Bank presents estimates using using an international poverty line (the share of the population living on less than \$1 per day) and an alternative relative poverty line (the share of population living on less than one-third of the average national consumption). Using the international poverty line, it appears that poverty in the developing world is shifting towards South Asia and Sub-Saharan Africa. Between 1987 and 1998, the share of population living on less than \$1 per day fell dramatically in East Asia and the Pacific (excluding China) from 23.9% to 11.3%, and remained low in Latin America (about 15%). However, the share of the population living on less than \$1 a day in South Asia and Sub-Saharan Africa remained roughly the same (40% and 46%, respectively). Even with the alternate relative poverty measure these same trends appear.<sup>7</sup>

Given the dramatic trade liberalizations in some of the East Asian and Latin American countries during this time period, in contrast to little or no liberalization in South Asia and Sub-Saharan Africa (respectively), it is likely that freer trade played a role in reducing or maintaining poverty levels in East Asia and in Latin America. However, other factors, such as the AIDS epidemic in Sub-Saharan Africa, financial crises in East Asia, and natural disasters in South Asia, Sub-Saharan Africa, and Latin America, have had a tremendous impact on poverty in these regions. War and the lack of rule of law may be critical in explaining the very sharp increase in poverty in Eastern Europe and Central Asia during this time period. Clearly trade policy alone cannot counteract the impact these and other shocks on poor households.

To echo both the Doha Ministerial Declaration and the Oxfam study, for countries to move towards more isolation would deprive the poor of the tremendous opportunities offered by international trade. Trade can be a powerful force to counteract poverty, but the present restrictions on that trade deprive poor countries and poor households of its benefits. Changes in trade policies of both industrial

---

<sup>7</sup> Latin America shows a much higher percentage of the population in poverty by this measure.

and developing countries should improve the nominal incomes and real purchasing power of poor households, thereby helping to build up physical and human assets and to reduce vulnerability to shocks. However, freer trade must be accompanied by complementary domestic policy reforms. Without these, its benefits may be greatly reduced.

## References

- Baldwin, R and E. Seghezza (1996). "Testing for Trade-Induced Investment-Led Growth," NBER Working Paper 5416.
- Dean, J. (2002). "Removing Textile and Apparel Trade Barriers: the Impact on Developing Country Exporters," manuscript prepared for the Office of the U.S. Trade Representative, May 16, 2002.
- Dean, J., S. Desai, J. Riedel (1994). *Trade Policy Reform in Developing Countries since 1985: A Review of the Evidence*, World Bank Discussion Paper No. 267, November 1994.
- Edwards (1998) Edwards, S. (1992). "Trade Orientation, Distortions, and Growth in Developing Countries," *Journal of Development Economics* 39, 31-57.
- Greenaway (1998) Greenaway, D., W. Morgan, and P. Wright (1998). "Trade Reform, Adjustment and Growth: What Does the Evidence Tell Us?" *Economic Journal* 108, 1547-1561.
- Harrison (1996) \_\_\_\_\_ (1996). "Openness and Growth: a Time-Series, Cross-Country Analysis for Developing Countries," *Journal of Development Economics* 48, 419-447.
- Oxfam (2002). *Rigged Rules and Double Standards*. UK: Oxfam.
- Ray, E. and R. Marvel (1984). "The Pattern of Protection in the Industrialized World," *Review of Economics and Statistics*.
- Rodriguez, F. and D. Rodrik (1999). "Trade Policy and Economic Growth: A Skeptic's Guide to the Cross-National Evidence," NBER Working Paper No. 7081.
- Spinanger, Dean, "Textiles Beyond the MFA Phase-Out," *World Economy* 22(4), June 1999, 455-76.
- Wacziarg, R. (2001). "Measuring the Dynamic Gains from Trade," *World Bank Economic Review* 15, 393-429.
- Winters, L. Alan (2000). "Trade and Poverty: Is there a Connection?" chapter 3 of Ben-David, D., H. Nordstrom, and L. Alan Winters, *Trade, Income Disparity and Poverty* WTO Special Study 5 2000.
- World Bank (2000). *World Development Report 2000*. Washington, DC: Oxford University Press.
- WTO (2001). *Ministerial Declaration*. WTO Document WT/MIN(01)/DEC/1.
- USITC (1997) *The Dynamic Effects of Trade Liberalization: an Empirical Analysis*. Publication 3069.
- USITC (2002). *The Economic Effects of Significant U.S. Import Restraints*, Third Update 2002.