

Trade Liberalization and Poverty

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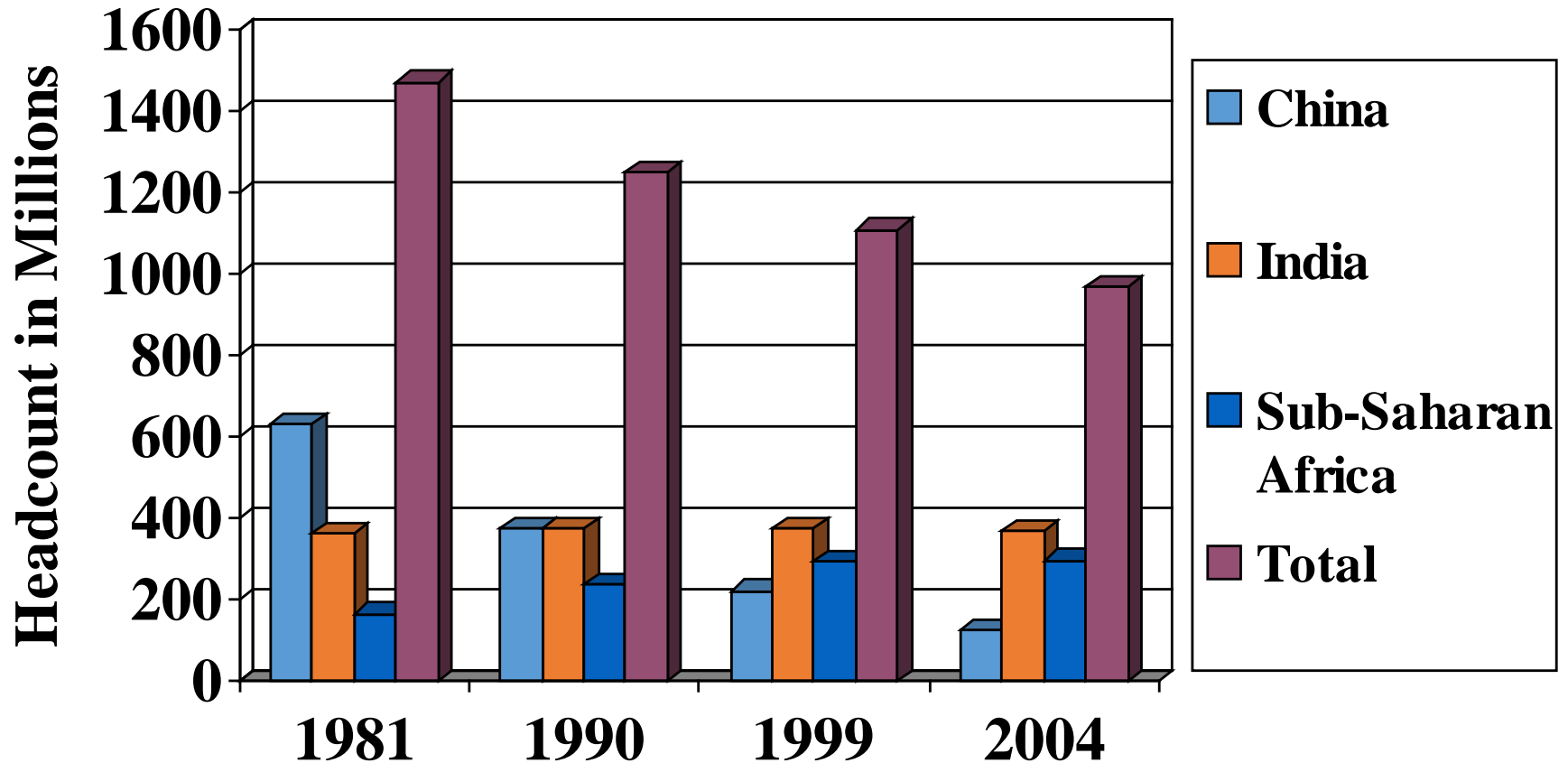
Poverty

- Today nearly 1 billion individuals lives under \$1 a day. Number of people living under \$1 a day as reduced from 32 percent in 1981 to 15 percent in 2004. (Ferreira and Ravallion, 2008).
- 2.5 trillion individuals (40 percent of world population) lives under \$2 a day.

	Number of Poor (in millions)	Percentage share in World Poverty
India	370.67	38.23
Sub-Saharan Africa	298.3	30.77
China	128.36	13.24
<u>Other</u>		
Latin America	47.02	4.85
East Asia Pacific (ex. China)	40.77	4.21
South Asia (ex. India)	30.84	3.18
Eastern Europe and Central Asia	4.42	0.46
Middle East and North Africa	4.4	0.45
Total	969.48	100.00

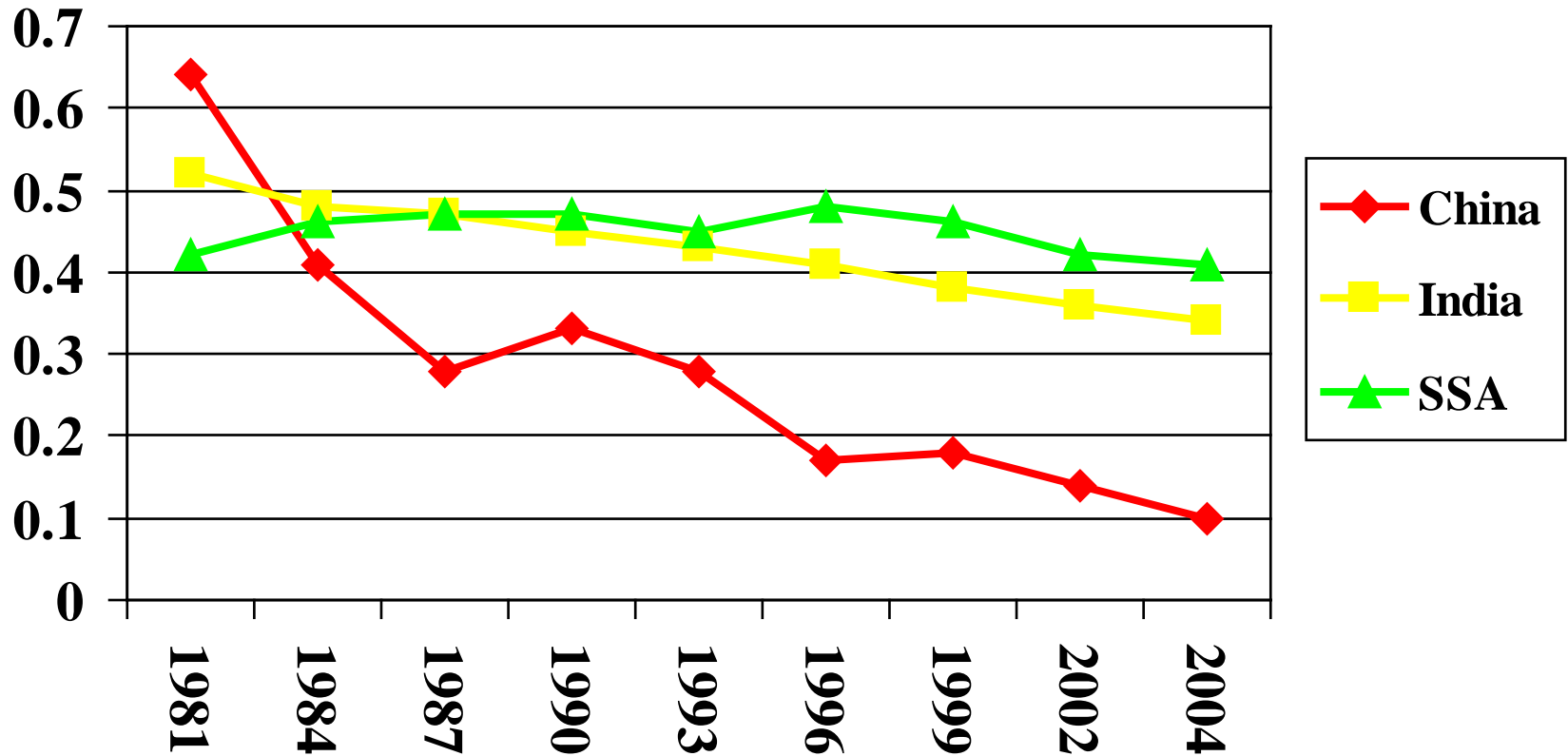
* Source: Ferreira and Ravallion (2008).

World Poverty Reduction



* Source: Ferreira and Ravallion (2008), World Bank.

Poverty Reduction within Country / Region

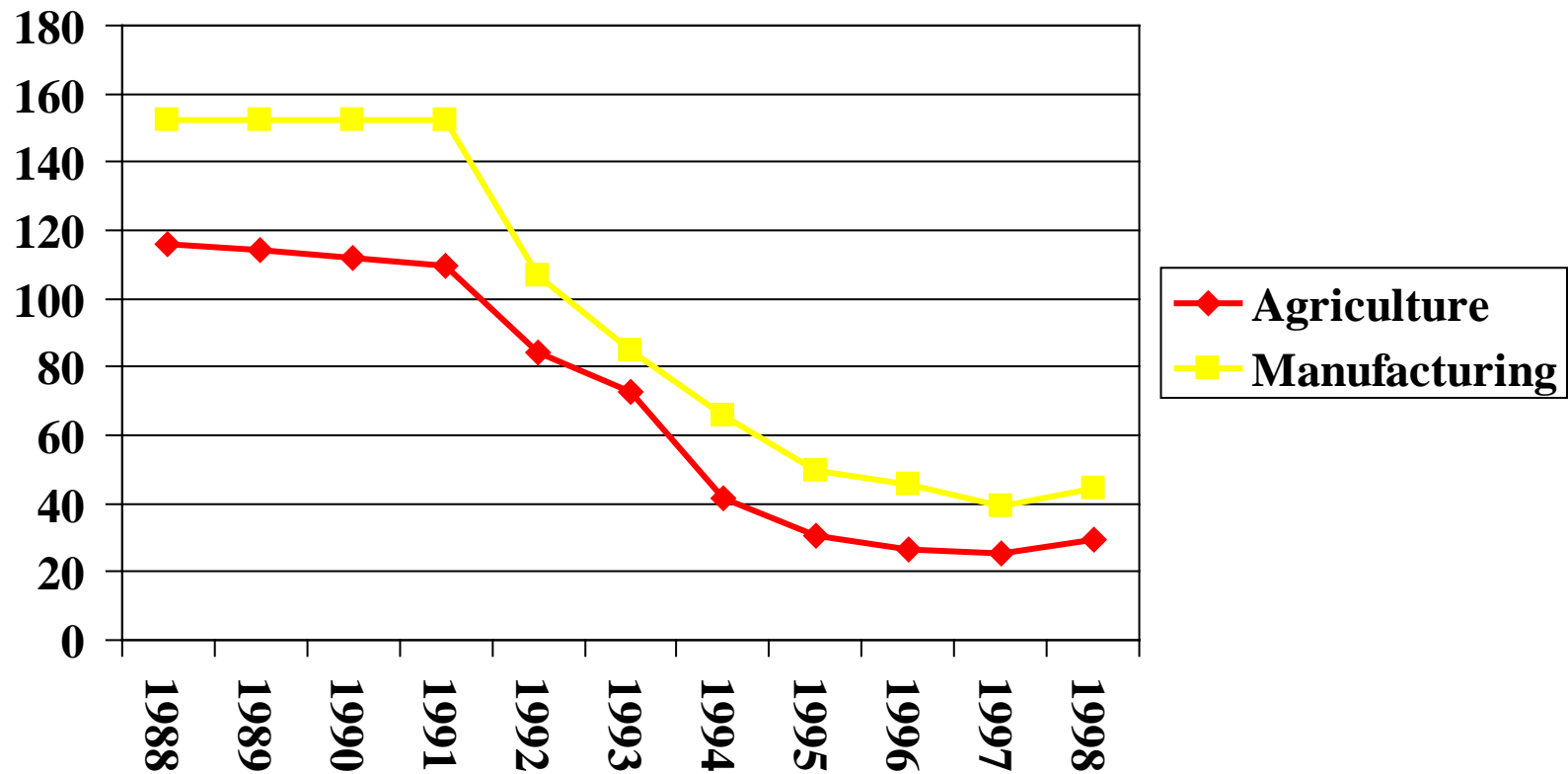


Source: Ferreira and Ravallion (2008); US Census Bureau International Database.

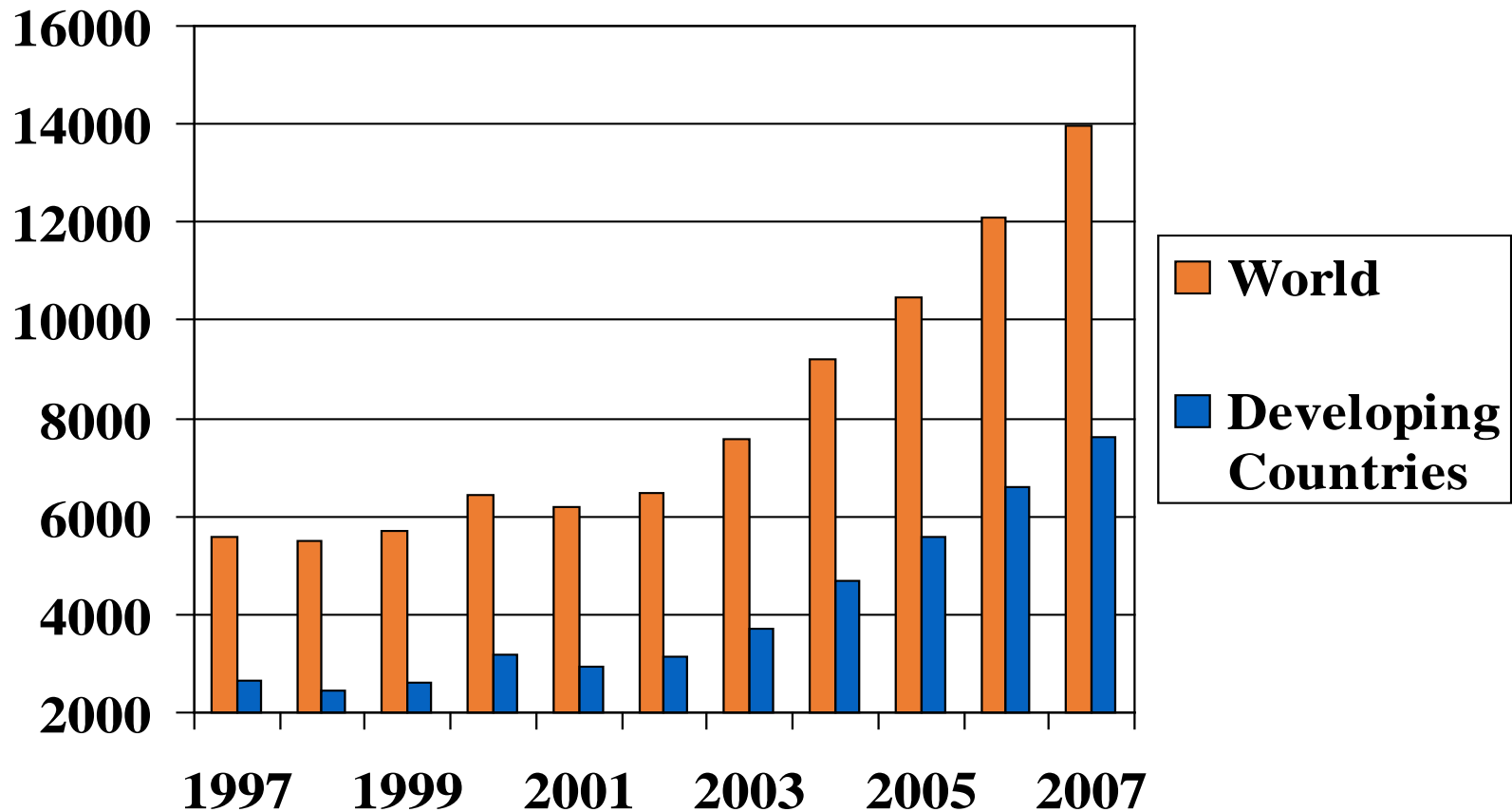
Trade Liberalization

- Significant reduction or removal of trade barriers that restrict a country's international trade.
- In 1960, only 22 percent of all countries had open trade policies. By 2000, 73 percent of all countries were open to international trade.
- Many developing countries lowered their trade barriers in 1980s.
 - Examples: Colombia (1986), Mexico (1986), Philippines (1988), Turkey (1989), Uruguay (1990), India (1991), China (2001).

Indian Tariff Rates Over Time



Developing Countries in the World Trade (in billions of dollars)

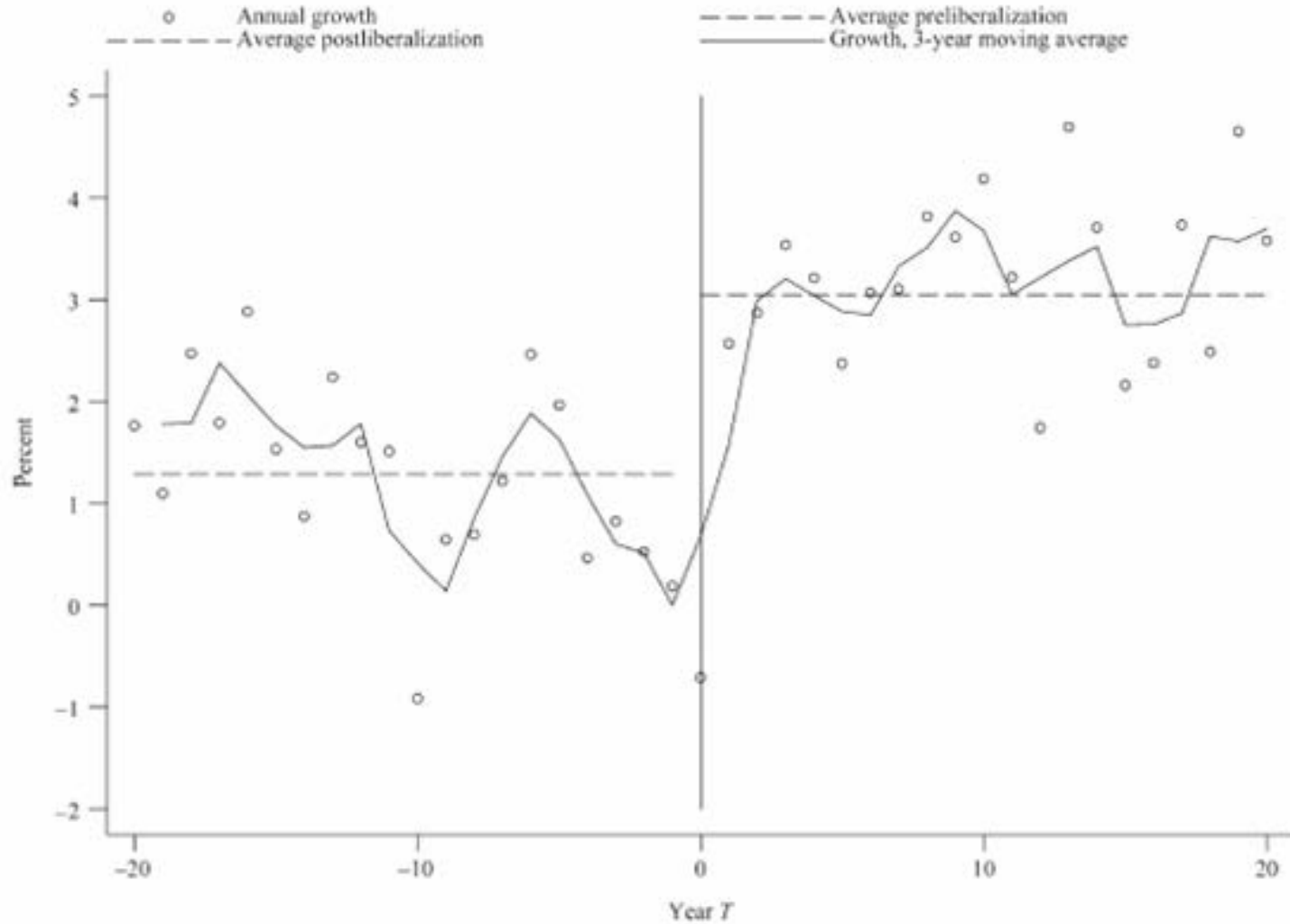


Source: World Trade Organization; World Bank Classification of Countries.

The Relationship between International Trade and Poverty

- Trade policy affects poverty through its effects on both growth and income distribution.
- Growth in gross domestic product.
 - Trade is not only engine for growth but it also sustains it.
 - Efficiency gains through larger varieties from specialization and exchange.
 - Evidence: Countries that are more integrated with global markets experienced higher growth rates.
 - Sachs and Warner (1995), Wacziarg and Welch (2008). Countries that are liberalized grow 1.53 percentage points faster than closed economy countries.

Sample Means for Growth before and after Liberalization



Source: Wacziarg and Welch, (2008).

Distributional Effects of Trade Liberalization

- Is the increase in income equally distributed within countries?
- Growth is good for the poor!
 - One percent increase in the per capita income reduce the number of people below poverty line by 2.5 percent. (Dollar and Kraay 2004)
- What is the effect of trade on income equality?
 - According to standard trade theory, openness should exert equalizing effect in poor countries and raise income inequality in rich countries.
 - We don't see this in the data. Increased inequality in Latin American countries vs. reduced inequality in South Asian countries.
 - Depends on the pre-reform conditions and labor content of international trade.

Distributional Effects of Trade Liberalization

- Pre-reform structure of protection: If the country has been protecting unskilled-labor intensive sectors (such as agriculture), then trade liberalization may hurt relative wages of the poor unskilled labor
 - = > increase income inequality.
 - The opposite is true in some cases (eg. Argentina).
- If the country is exporting products that use relatively less labor
 - = > increase in income inequality.

Country-specific policies and institutions

- Labor market institutions
 - Pro-labor policies restrict free labor mobility. In this case there is no significant improvement in the wages of unskilled labor.
 - In India, trade liberalization was associated with larger poverty reduction in states with flexible labor market institutions.
- Policies and institutions that support economic freedom
 - Government size, price stability, property rights, rule of law, etc. contribute significantly to poverty reduction. Evidence: Hasan, Quibria and Kim (2003)

What can be done?

- Improvements market access
- Improvements investment climate
- Improvements human capital investment, health and empowerment
- Trade negotiations that focus on making the existing rules fairer
- More and better aid
- Debt relief for reforming countries