IS TRADE LIBERALIZATION REALLY ALL THAT GOOD FOR GROWTH, LET ALONE REDUCING INEQUALITY AND POVERTY?

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There seems to be little consensus on the relationship between trade liberalization and poverty. Many economists presume that trade liberalization contributes to both growth as well as reducing inequality, although there is little incontrovertible supporting evidence.

The theoretical and empirical bases for this presumption are also dubious. Even the neoclassical Hecksher-Ohlin trade theory suggests gains from trade may be very unevenly distributed, depending on initial conditions (factor endowments), outcomes, etc..

Theory is an even poorer guide to the likely distributional consequences of partial and uneven trade liberalization. Most trade theory only considers static – rather than dynamic – consequences of trade liberalization and related resource allocation. In any case, most of this discussion focuses on trade and growth, and only indirectly on inequality and on poverty.

Thankfully, most serious researchers of inequality in our stream were careful in attributing causation, especially between trade liberalization and poverty reduction, whether through labor market vulnerability (Bourguignon & Goh) or in poor rural areas (Chen & Ravallion).

The relationship between trade and, more generally, economic liberalization on the one hand and inequality and poverty on the other loomed large in the background.

Bhalla forcefully argued that poverty has fallen considerably in the last decade due to growth (thanks to liberalization), which has been biased (1.8 times) in favor of the poor. According to Bhalla, the Millennium Development Goals for poverty

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reduction have already been achieved as the poverty line used by the World Bank is too high and incomes have been consequently understated. He suggested that World Bank and other researchers arguing the contrary have been methodologically sloppy and dishonest in order to exaggerate poverty to justify the Bank's continued role as self-proclaimed 'champion of the poor' and its control of 'soft money'.

The relationship between liberalization and growth is complex and variable. In the post-war period, growth has generally been much higher before rather than since the 1980s, except in China and India, which have accounted for so much of recent poverty reduction, but, arguably, remain among the world's least liberalized economies (excepting North Korea, of course).

Most economies in the world have, at some point, used trade policy instruments – including protection – to accelerate growth, especially industrialization. While some measures have undoubtedly been abused and/or have been in egalitarian in impact, the Northeast Asian experience for most of the second half of the 20th century was one of major trade distortions, low inequality and rapid poverty reduction.

Anderson used a CGE model to advocate agricultural trade liberalization, which Yamazawa noted, will primarily benefit the rich countries.

Anderson also showed greater terms of trade (ToT) losses due to trade liberalization for most tropical developing countries. He estimated economic welfare losses in 2005 of around US$22 trillion in Southeast Asia, China and India from the complete removal of trade barriers globally.

Considered against the Prebisch-Singer finding of declining terms of trade for primary products against manufactures, the Lewis finding of worse declines for tropical – compared to temperate – primary products and the more recent terms of trade fall for generic manufactures.

All this revives the specter of Bhagwati-type 'immiserizing growth' with more intense export competition, e.g., as has happened with cocoa and coffee.

It also helps explain the greater significance of international inequalities compared to intra-national inequalities in apparently growing world inequality.

This also seems to be contributing to ongoing East Asian deflation, which, as Fisher explained in the 1930s, threatens to depress growth in the region and beyond.

There is growing concern that trade liberalization under WTO auspices has been more onerous than under GATT, especially for the least developed countries which are obliged to implement liberalization programs determined by powerful governments for influential transnational corporate interests, albeit in an ostensibly consensual participatory process. Many ‘handicaps’ for developing countries under GATT have been wiped out in the process of ‘leveling the playing field’.

While insisting that trade liberalization is good for growth and for poverty reduction, Kharas stressed the need to focus on the vulnerable. Meanwhile, Quibria noted that short-term impacts may be very bad, even if ameliorated in the medium or long term.

Hence, developing countries are being urged to develop social safety nets requiring fiscal and targeting capacities already eroded by ongoing liberalization. However, social safety nets can also serve as progressive, counter-cyclical, compensatory mechanisms.

With the recent global slowdown in economic growth, export markets have shrunk, reducing the viability of export-led growth. The corresponding decline of ‘green-field’ foreign direct investment, despite low interest rates, is ominous.

With the erosion of earlier productive capacities by trade liberalization, renewed reliance on domestic-led growth has not been easily achieved as many trade policy instruments are no longer available.

While international trade theory promises some comparative advantage for all, actual trade liberalization risks condemning much of humanity to the margins of history and existence.