# When is Trade Good for the Poor? Evidence from Recent Literature

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Abstract:

The paper reviews recent literature that tries to find the relationship of trade with economic growth, poverty and inequality. The analysis suggests that trade may be good for the poor but if it leads to inequality especially in industrial wages, it may be detrimental to sustainable economic development. A valid strategy to make trade good for growth and the poor is to invest in education at all levels. A gender sensitive education policy may go a long way in sowing the seeds of better economic management.

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## 1. Key Determinants of Economic Development

Economic growth cannot be seen in isolation with its impact on poverty and inequality. To understand the effects of growth on the poor, we need to analyze growth promoting policies. Since 1990s poverty has significantly decreased in the world as it is estimated that 400 million people now live above the poverty line. Though, majority of developing countries have embraced economic reforms in 1980s and 1990s, the trends in poverty alleviation are not homogenous across the developing world. The figure of 400 million only accounts for the decrease in poverty in China; where as poverty in South Asia minus India and Sub-Saharan Africa has increased whereas in Latin America poverty trends are stagnant. In addition to such heterogeneous experiences in poverty alleviation, inequalities all over the globe are at constant rise. So much so, many recent reports by international bodies have raised alarm on rising trends in disparities. It becomes of vital importance to understand why growth promoting policies have led to poverty alleviation in some countries and not the others. Secondly in line with the recent calls for understanding the determinants of inequality, it is important to look at not only income inequalities but also qualitative disparities and how they are related with various determinants of economic development.

## 2. Are Institutions more Important than Integration?

Mamoon and Murshed (2017) examine the contribution of trade liberalisation upon poverty via its impact on per-capita income levels. They compare with the relative contribution of institutional capacity to prosperity, as well as the role of human capital accumulation in that respect. Several concepts of institutional quality, trade policy and openness variables were employed following various definitions prevalent in the literature. The ratio of nominal imports plus exports to GDP is the conventional openness indicator, with the likes of overall trade penetration and overall import penetration. Neither of these measures are direct indicators of trade policy of a country, pointing only towards the level of its participation in international trade. There are indicators of trade restrictiveness acting as measures of trade policy, including import tariffs as percentage of imports, tariffs on intermediate inputs and capital goods, trade taxes as a ratio of overall trade and total import charges can all be considered as good proxies of trade restrictiveness .Unlike in the comparable study by Rodrik et al (2004) Mamoon and Murshed (2017) have (a) included a role for human capital, (b) employed six institutional variables compared to one only in Rodrik et al (rule of law), (c) included trade policy variables and not just openness indicators and (d) expanded the set of openness measures employed. They find taht opening up domestic markets to foreign competition by revoking trade restrictions and trade barriers can be good for economic performance. Secondly, developing human capital is as important as superior institutional functioning for economic wellbeing. Indeed, the accumulation of human capital stocks via increased education might lead to improved institutional functioning, and the utilisation of policies like trade liberalisation. With regard to the role of international integration versus institutions,openness counts for little *per se* in explaining income differences across countries. This is because it is an outcome and not a cause. Trade policies, and liberalisation, on the other hand, are not insignificant in explaining cross-country per-capita income variation. With regard to trade policies the overall policy stance, particularly those associated with black market premia in foreign exchange markets and export taxes, are most important in explaining differences in income across countries.

## 3. Institutions, Integration and Inequality

Mamoon (2006) estimates the respective contributions of legal, economic, political and social institutions on inequalities across the globe Institutions have significant effects on inequality. Among legal institutions, rule of law and control for corruption have a stronger impact on inequality than voice and accountability. Countries which practice democracy are less prone to unequal outcomes, we also find that autocratic setups may not necessarily lead to greater inequalities. Both frameworks may carry redistributive effects, as both are positively associated with the incomes of the poorest and negatively associated with the incomes of the richest. Secondly, whether a country is politically stable is rather a more decisive institutional factor apropos inequality than whether a country has an autocratic or a democratic orientation. Economic institutions also seem to play an important role in alleviating global inequalities. Whether the government is functioning effectively and whether it has a robust fiscal and monetary policy seems to have stronger impact on inequality than regulatory quality Education for all, a proxy for social institutions, has a strong redistributive power as well as a more literate adult population. General trade levels are associated with increased wage inequalities across nations. However the relationship between trade and income inequalities has largely been insignificant.

## 4. How may International Trade affect Inequality in a developing country Setup?

High initial endowments of human capital imply a more egalitarian society. When more equal societies open up their economies further, increased trade is likely to induce less inequality on impact because the supply of skills better matches demand. But greater international exposure also brings about technological diffusion, further raising skilled labour demand. This may raise wage inequality, in contrast to the initial egalitarian *level* effect of human capital. Mamoon and Murshed (2013) attempts to measure these two opposing forces by further examining what type of education most reduces inequality. The findings suggest that countries with a higher level of initial human capital do well on the inequality front, but human capital which accrues through the trade liberalization channel has inegalitarian effects. One explanation could be that governments in developing countries invest more in higher education at the expense of primary education in order to gain immediate benefits from globalization; thus becoming prone to wage inequality after increased international trade. Their findings also have implications for the speed at which trade policies are liberalized, the implication being that better educated nations should liberalize faster.

## 5. Education Policies in the South

A successful higher education reform in the South is not limited to improvement in quality and access to higher education but it should directly and indirectly cater to the millennium development goals by ensuring pro poor pro growth outcomes. Once we link higher education reforms with a development agenda or strictly speaking millennium development goals, the reform process in higher education becomes much more than a mere pro growth strategy. Mamoon (2007) identifies ways in which the reform process in higher education is aligned with the larger development agenda of the South. To this effect, the issue that lie in the peripheries of higher education reform debate,is to directly link up higher education policy to overall education policy formulation in the South. Generally governments in the South promote higher education at the cost of primary education, and thus indirectly undermine the effectiveness of their development strategies. As per decomposition, poverty can be either affected by economic growth or unequal distribution of income. In order to investigate whether higher education, as it prevails in the South, is good for the poor, they analyse relationship of average years of higher schooling at age of 25 with economic growth and inequality. The paper undertakes regression analysis by utilizing 5 different proxies of economic growth/ economic development and 4 proxies for income inequality as basis for 14 separate IV regression models. Average years of higher schooling have been used as the common regressor. They find that higher education is a significant determinant of economic development. However, our inequality regression models suggest that education policies in general and higher education policies in specific do not cater for the lowest income groups in the South and if anything higher education favors the more affluent. The study recommends that higher education policies should not be implemented in isolation with over all education policy frameworks. As a first step to this more coordination is recommended between higher education commissions and education ministries in the South.

## 6. Gender gap in Education and International Trade

It may be extremely useful to have a look at the gender profiles of the countries. It is a common knowledge that in most developing countries there are severe gender inequalities in earnings as well as skills. Men have the major share in employment, education, incomes as well as public and private investment. In the context of prevalent gender inequalities how trade functions as engine of growth and how it acts for the wellbeing of the poor are important research questions. Recently there is advent of literature which tries to analyse the effects of trade on women development by primarily investigating the impact of trade liberalization on livelihoods of women. There is evidence that trade has improved the plight of women as they move from low paid informal sector to high paid formal one. However, the distribution of benefits seems to favor men compared to women. For example in the export oriented garment industry in Bangladesh females are paid significantly less than their male counter parts in all job categories. Women are highly under-represented at managerial levels, and over represented at the lower tiers of employment. Although female workers earn less than their male counterparts even with the same level of education and experience, the male-female wage gap drastically falls with higher levels of education. It is true that the comparative advantage of developing countries lie in their cheap labor but there is a caveat. The trends of high employment of women at low levels in export industries in Asian countries like Bangladesh, China, India, Malaysia, Srilanka, Taiwan, Indonesia indicate that women form the most cost effective of unskilled labor force in terms of wages. However, this cheap labor is generally provided at the cost of gender discrimination because the export industries seem to conveniently utilize from the excess supply of unskilled and uneducated women, who due to their low levels of participation in formal labor setups in pre-liberalization period are more likely to be employed as temporary workers: an arrangement though not a preferred option to the work force of any country but quite beneficial to the producers in export industry as temporary employment arrangements prevents wages to rise. On account of social, cultural and historic handicaps which women face in developing countries (i.e., lack of education and their involuntary participation in informal sectors), further gender exploitation takes place in the economy once it opens up. Trade does not seem to give women the fair deal. Some level of gender discrimination may very well be put as yet another short term adjustment cost to be paid for liberalizing, but this phenomenon has yet to receive any significant attention in economic research despite its apparent application for the success or failure of poverty reduction and growth strategies and despite the recent emphasis of development initiatives (i.e, SDGs) on making trade not only free but also fair.

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