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DISCUSSION

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How trade openness can help to 'deliver the poor and needy'

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> *Defend the poor and fatherless: do justice to the afflicted and needy. Deliver the poor and needy.*
>
> (Psalms 82: 3–4, KJV)

1 | INTRODUCTION

According to the World Bank (2018), extreme poverty (i.e. less than $1.90 a day) has plummeted from 36 per cent of the world population in 1990 to 10 per cent in 2015. This information is not as well-known as it should be.

A Barna Group survey (2014) found that 84 per cent of Americans are unaware that extreme poverty worldwide has decreased by more than half in the past three decades. Sixty-seven per cent said they thought global poverty was actually *increasing* during that time. Similarly, a later study (Lampert & Papadongonas, 2016) found that only 8 per cent of Americans *and* Germans believe extreme global poverty has decreased in the last 20 years. In India and Indonesia, it was respectively 27 per cent and 16 per cent.

Given the ignorance surrounding global poverty's decline, the *reasons* for its decline are probably even less known. As *The Economist* (2013) reports, "The world's achievement in the field of poverty reduction is, by almost any measure, impressive". The United Nations'

> *aim of halving global poverty between 1990 and 2015 was achieved five years early … The [Millennium Development Goals] may have helped marginally, by creating a yardstick for measuring progress, and by focusing minds on the evil of poverty. Most of the credit, however, must go to capitalism and free trade, for they enable economies to grow – and it was growth, principally, that has eased destitution.*

This last statement about free trade and economic growth is often controversial in the popular press and among political leaders. However, pro-trade endorsements are *not* controversial among professional economists (Mankiw, 2015a). For example, a 2009 survey of members of the American Economic Association found that 83.3 per cent agreed that "the U.S. should eliminate remaining tariffs and other barriers to trade" (Whaples, 2009, p. 340). According to Mankiw (2015b, p. 32), 93 per cent of economists agree with the following statement: "Tariffs and import quotas usually reduce general economic welfare."

Consensus, however, is not evidence. Fortunately, there is plenty of empirical evidence that trade decreases poverty through various avenues (e.g. Council of Economic Advisers, 2015a,b; Bartley Johns, Brenton, Cali, & Hoppe, 2015; Bartley Johns, Brenton, Piermartini, Sadni Jallab, & The, 2018; World Bank, 2020), including innovation (e.g. Coelli, Moxnes, & Ulltveit-Moe, 2016; Shu & Steinwender, 2019) and institutional change (e.g. Levchenko, 2013).

However, this article focuses specifically on the connection between trade, growth, and poverty. This is in order to respond to the dismissive view that modern trade policies promote growth merely for the sake of growth at the expense of the poor and marginalised.[1] As Steve Horwitz (2013) explains,

> *Critics of markets sometimes say 'you can't eat GDP.' What they miss is that you can't eat, or learn to read, or go to school, or leave a bad marriage, or do pretty much any of the basics that we might see as required for a flourishing life without the wealth and time created by the market.*

Section 2 of this article provides some evidence for the connection between economic growth and poverty reduction. Section 3 reviews the evidence demonstrating that trade liberalisation boosts economic growth, leading to poverty reduction in trade-oriented countries. Section 4 mines the more scanty research on the *direct* effects of trade liberalisation on poverty. As will be shown, the evidence overwhelmingly suggests that trade liberalisation reduces poverty both *indirectly* and *directly*. If the poor and destitute are of any concern, then encouraging greater integration into the global trade network is a must. Section 5 concludes.

2 | ECONOMIC GROWTH AND POVERTY

Jagdish Bhagwati (2004, p. 64) argues that "freer trade is associated with higher growth and … higher growth is associated with reduced poverty. Hence, growth reduces poverty." However, empirically establishing this connection between growth and poverty reduction is necessary, seeing that it is theoretically possible for the benefits of economic growth *not* to be distributed to the poorest segments of society.

Using a sample of 92 countries over a 40-year period, David Dollar and Aart Kraay (2002, p. 219) find that economic growth on average increases "the income of the poor to the same extent that it increases the income of the other households in society". Kraay (2006) finds that the main explanation for cross-country differences in poverty shifts over time is the growth in average incomes: 70 per cent in the short-run and 97 per cent in the long-run, respectively. In a follow-up study, Dollar, Kleineberg, and Kraay (2016, p. 81) examine a data set of 121 countries over four decades and come to the same conclusion: "Incomes of the bottom 20 percent and bottom 40 percent of income distribution generally rise equiproportionally with mean incomes as economic growth proceeds."[2]

In a book-length treatment on the economic reforms in their home country of India, Bhagwati and Arvind Panagariya (2013) find that the growth since the 1990s has reduced poverty nationwide in rural and urban regions alike and among socially disadvantaged groups.

Finally, a recent paper by Lant Pritchett (2018) demonstrates that the bulk of poverty reduction worldwide is due to economic growth and migration. These studies confirm the solid connection between economic growth and poverty reduction.

3 | INDIRECT EFFECTS: TRADE AND ECONOMIC GROWTH

According to Bhagwati (2004), trade openness produces growth through various channels, including specialisation, economies of scale, increased competition (and, consequently, decreased domestic monopolies), promotion of macroeconomic stability, and increased foreign direct investment. Close to three decades of empirical evidence support this view that trade openness results in growth.

David Dollar's (1992) early analysis of 95 developing countries between 1976 and 1985 concludes that trade openness (what the author calls an "outward-orientation") and per capita GDP growth are highly correlated. Similarly, Jeffrey Sachs and Andrew Warner (1995, p. 45) show in a cross-country analysis that, between 1970 and 1989, "being open to international trade has been sufficient to achieve growth in excess of 2 percent for developing countries".

Various studies from around the turn of the twenty-first century provide continued support for the connection between trade openness and economic growth (Frankel & Romer, 1999; Yanikkaya, 2003; Cline, 2004). While scepticism about this connection was inevitable (Rodriguez & Rodrik, 2001; Rodrik, Subramanian, & Trebbi, 2004),[3] the scholarly community responded in force (e.g. Srinivasan & Bhagwati, 2001; Bhagwati & Srinivasan, 2002; Noguer & Siscart, 2005; Dollar and Kraay, 2004).

Lewer and Van den Berg's (2003) review of this literature finds that, on average, studies point to a one-fifth (or more) percentage point increase in real GDP for every percentage point increase in trade. Winters, McCulloch, and McKay (2004) are slightly more cautious in their review, but ultimately admit that the preponderance of evidence suggests that trade openness increases economic growth and income levels within countries.

Research over the last decade continues to support the earlier findings (e.g. Wacziarg & Welch, 2008; Estevadeordal & Taylor, 2013; Were, 2015; Brueckner & Lederman, 2015; Zahonogo, 2016;[4] Gnangnon, 2017; Artuc, Porto, & Rijkers, 2019). Douglas Irwin's (2015, p. 197) survey of the evidence finds that "greater trade openness – marked by rising trade and low or declining trade barriers – has been a feature of virtually all rapid-growth developing country experiences in the past fifty years". Examining countries such as China, India, South Korea, Chile, and Vietnam, Irwin concludes that liberalised trade has been associated with greater growth and, consequently, declining poverty.

In a recent book, Arvind Panagariya dedicates extensive attention to "economic miracles" such as Hong, Kong, Singapore, Taiwan, South Korea, India, and China. He then turns to other economic successes throughout Asia and Africa (and even moderate ones in Latin America). He finds that "in each case, trade liberalization and expanding trade are integral parts of the success story" (Panagariya, 2019, p. 322). Panagariya also compiles "data on per capita incomes, good and services exports, goods and services imports, and goods and services exports as a proportion of GDP in constant 2005 U.S. dollars for more than two hundred countries over a period of fifty-four years between 1960 and 2013" (2019, p. 98).[5] With exhaustive detail, he demonstrates a causal relation between trade and per capita income: those countries that experienced intensive growth in these various periods always maintained a high and/or expanding trade-to-GDP ratio.

This finding is supported by Winters and Martuscelli's review of the literature. They conclude that “the evidence is very strong that greater openness is generally associated with higher levels of income and, equivalently, that trade liberalization is associated with temporary increases in growth. The relationship appears to be causal but is not absolutely invariable” (Winters & Martuscelli, 2014, p. 498). Similarly, a more recent review (Irwin, 2019, p. 21) determines that “findings from recent research have been remarkably consistent” in establishing “a measurable economic payoff from more liberal trade policies”.

While complementary domestic policies (for example, improvements in institutional quality) may be necessary to reap the full benefits of international trade,[6] there appears to be no substantial evidence suggesting that trade has anything other than positive effects on growth. The overwhelming majority of studies support the claim that trade reduces poverty through increased economic growth. As Caplan (2019) points out in the 2019 Hayek Memorial Lecture, the evidence shows that “just *avoiding* a short and clear list of *awful* economic policies – which basically come down to socialism, expropriation, and autarky – is a *sufficient* condition for long-run economic growth. In other words, *avoid these policies* and you will grow with virtual certainty.”

4 | DIRECT EFFECTS: TRADE AND POVERTY

The majority of studies on openness and poverty concentrate on trade's effects on economic growth and, consequently, growth's effects on poverty. This means that there is only a meagre amount of literature *directly* linking trade openness and poverty. Nonetheless, a few more recent studies have attempted to look at the direct linkage between trade liberalisation and poverty.

Measuring trade openness by the trade-to-GDP ratio and average tariffs, Aisbett, Harrison, and Zwane (2008) confirm previous studies in a cross-country analysis showing a strong link between trade and increased aggregate income growth. However, when the *direct* link between trade and poverty is measured, the tie is weakened considerably. Nonetheless, the direct association between trade and poverty remains positive, if not always statistically significant.

A more recent study finds a stronger direct tie between trade and poverty. Updating the data of Aisbett et al. (2008) with more recent years and the World Bank's new poverty headcount ratio, Mitra (2016, p. 65) has shown that in the period 1981–2013 “a single percentage point increase in trade leads to a poverty decline of 0.149 percentage points”.

Petia Topalova (2007, p. 293) explores the effect of trade liberalisation – measured by the weighted tariff average – on various districts within India from the late 1980s throughout the 1990s, and comes to a more pessimistic conclusion: “. .. trade liberalization led to an increase in poverty rate and poverty gap in the rural districts where industries more exposed to liberalization were concentrated”. However, a response article by Hasan, Mitra, and Ural (2007) actually *reverses* Topalova's results after more robust measurements are taken in consideration (i.e. the inclusion of non-tariff barriers, the avoidance of non-tradable employment weights,[7] and better sampling data from state-level measures). Hasan et al. “find that states whose workers are on average more exposed to foreign competition tend to have lower rural, urban and overall poverty rates (and poverty gaps), and this beneficial effect of greater trade openness is more pronounced in states that have more flexible labor market institutions” (2007, p. 75). A follow-up study with the latest available data (Cain, Hasan, & Mitra, 2012) comes to the same conclusion, finding that 38 per cent of the poverty reduction between 1987 and 2004 was the result of increased trade liberalisation.

Bergh and Nilsson (2014) analyse 114 countries from 1983 to 2007, breaking the poverty data down into four five-year periods. In order to test economic globalisation's causality, they control for (*a*) the number of years McDonald's Corporation franchises have operated in the country and (*b*) the preceding average level of economic globalisation of the neighbouring countries. They discover that while trade flows lead to reductions in poverty, the result's significance disappears once they control for income and growth. However, even after those controls, liberalised trade restrictions have a large poverty-reducing effect (along with information flows).[88]

Despite some mixed results, the most up-to-date research supports the conclusions of the previous section that international trade ultimately leads to reduced poverty.

5 | CONCLUSION

In her book *Open*, Kimberly Clausing (2019, pp. 65–6) writes,

> *Openness to the world economy has played an important role in one of the most encouraging developments in human history: the dramatic increase in worldwide living standards in recent years … International trade is not solely responsible for these impressive achievements, but it has played a key role.*

Trade has done an enormous amount of good for the poor worldwide and will continue to do so as long as policymakers and the public steer clear of populist-fuelled protectionism.

NOTES

[1] There is also a heavy focus on income inequality rather than poverty itself. While outside the scope of this article, it is worth noting that global income inequality has also declined (Liberati, 2015; World Bank, 2016).

[2] See also Dollar, Kleineberg, and Kraay (2015).

[3] Despite their dismissal of trade's importance when it comes to growth, Rodrik, Subramanian, and Trebbi (2004, p. 143) acknowledge that institutions and integration positively influence each other: “A unit increase in institutional quality increases the trade share by 0.45 units, while a unit increase in trade increases institutional quality by 0.22 units.” In short, Rodrik et al. find that trade increases growth via institutional improvement.

[4] Zahonogo (2016) argues for a Laffer Trade Curve in sub-Saharan Africa. He finds that for most measures, the thresholds are virtually non-existent: the threshold for the sum of exports and imports is 134.21% of GDP, whereas the threshold for exports is an astronomical 355.68% of GDP. However, when imports make up for more than 33.16% of GDP, the positive effects of trade on growth begin to decline. He suggests complementary policies that promote new investments, improve institutional quality, and develop human capital.

[5] This is broken into three smaller periods: 1961–1975, 1976–1994, and 1995–2013.

[6] Mexico is a clear example of domestic policies blunting some of the positive impact of trade (see Hanson, 2010; Levy, 2018). Nonetheless, trade agreements such as the North American Free Trade Agreement have been beneficial to the Mexican economy. See Salvatore (2007), O'Neil (2013), Caliendo and Parro (2015), and Villareal and Fergusson (2017).

[7] Topalova (2007) assumes the tariffs on non-tradables to be zero, but the reason they are not traded could very well be due to high tariffs.

[8] These information flows can also substitute for poor institutions and consequently reduce poverty despite low institutional quality (Bergh, Mirkina, & Nilsson, 2016).

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