Under which conditions can trade be an engine for poverty reduction?

By

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EXPERT GROUP MEETING ON SDGI

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BIG QUESTION: Under which conditions can trade be an engine for poverty reduction?

Answer:

1. When a country is better integrated into the world economy.
   • Indeed, Dollar (2001 p. 17) argues that the only developing countries that have registered significant declines in poverty are those that also have integrated faster into the world economy on the dimensions of trade and direct investment. ” (emphasis mine) Bhagwati and Srinivasan (2002, AER, p. 182)
   • Integration to take advantage of the Global Value Chains (GVCs), etc.
   • But how?
When a country has reached a sufficiently high level of globalization (trade liberalization) Agenor (2004, IEEP) finds an inverted U shape.

But will the threshold ever be reached?
Answer:

• 3. When a country has **better attributes**: financial (private credit), education, strong institutions (bureaucratic quality).

  - African evidence: “Using a panel of African countries over the period 1981-2010 and testing for non-linearities in the trade-poverty relationship, we find that **trade openness tends to reduce poverty in countries where financial sectors are deep, education levels high and institutions strong.**” (emphasis mine) LeGoff and Singh (2014, p.1)

• **But** how?
Answer:

4. General conceptual answer: When trade increases economic growth faster than it increases inequality (alternatively, when growth generated by trade does not exacerbate inequality too much)

- Evidence on the impact of trade on growth: showing a positive impact of trade on economic growth is strong:
  
  I. E.g., Based on a survey of the literature, Singh (2010) observes: “The macroeconomic evidence provides dominant support for the positive and significant effects of trade on output and growth.” (emphasis mine) (Singh, 2010, World Economy, p. 1517)
II. Specifically, “Our survey reveals that the many empirical studies are surprisingly consistent in terms of the size of the relationship: A one percentage point increase in the growth of exports is associated with a one-fifth percentage point increase in economic growth. Given the power of compounding, the effect of trade on growth is very important for human welfare.” (my emphasis) Lewer and Van den Berg (2003, J Econ Surveys, p. 363)

III. Interestingly, for African economies, the estimate is .10 (instead of the above global estimate of .20); see Fosu (2001, JAE; 1990, World Dev.)
Answer:

5. But how crucial is economic **growth compared with improvements in inequality** in reducing poverty?

On average, **growth** has been the main engine for poverty reduction

- Globally (e.g., Fosu, 2017, Res In Econ; Dollar and Kraay, 2002, JEG)
- SSA (Fosu, 2015, Oxford Dev Studies)

- Thus, the usual (inclusive) growth policies under trade are crucial.
Answer:

6. And the rate of transformation (from economic growth and/or inequality changes to poverty reduction) is critical: the income and inequality elasticities of poverty.

- These elasticities differ significantly across regions and countries (Fosu, 2017, Res in Econ, table 6):
  - Income Elasticity: -3.68 (EECA) to -1.26 (SSA) [Global: -2.34]
  - Inequality Elasticity: 5.71 (EECA) to 1.10 (SSA) [Global: 3.22]
6. What factors, then, influence these elasticities?

- Conjecture: Governance factors
- For example, for SSA, all the six Worldwide Governance Indicators (WGI) are significantly negatively associated with poverty growth, but are not significantly associated with either income or inequality changes, though to differing degrees. (Fosu, ongoing research)
- Results differ by regional groups, however. (Fosu, ongoing research)

(WGI = Control of Corruption, Government Effectiveness, Voice and Accountability, Rule of Law, Political Stability and Absence of Violence/Terrorism, Regulatory Quality)

- But how can these be generated?

- The role of democracy = ? (positive but weakest for IEC and strongest for XCONST, with Polity2 in-between)

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7. Does **export type: export diversification** matter? (Fosu UNCTAD paper?)

- Apparently, yes (see table below: Fosu, ongoing research)

### Zero-order Correlation Matrix

<table>
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<th>Developing countries</th>
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<td>0.2728***</td>
</tr>
</tbody>
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Answer (conclusion?):

- 8. What then determines Export Diversification? (Research interest, thanks to UNCTAD.)
- Answer: To be discussed or next expert-group meeting?!
- Conclusion: No simple answers!

- Thank you!