

Comment on
Trade, Growth and Poverty: Re-examining the Linkages

By
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1. Let me begin by noting that this is a very interesting and in places very provocative paper and I must confess I never felt bored reading it. I am in full agreement with Dr. Bhalla on all the broad issues. That of course makes my task as a commentator an extremely difficult one, besides the fact that I had a short time to review it.
2. As this seminar is part of the Asian Development Forum, I would desist from getting into technical discussions, because that will defeat the purpose of the present forum. My comments will therefore essentially focus on general analytical and policy issues. In doing so, I will venture to add some new issues that are germane to the present discussion and elaborate on others touched upon in the Bhalla paper. I will then try to relate them to some of the quotidian concerns of real world policymakers.
3. As Dr. Bhalla has explained in his presentation, the paper explores the interrelationship between trade, growth, and poverty. To empirically establish the linkage, the paper poses the question in two parts. The first part concerns the relationship between trade and growth, and in exploring this relationship the author has made a contribution to the ever-expanding empirical growth literature. The second part deals with the relationship between growth and poverty.
4. The paper finds that trade had a very significant impact on enhancing growth. During the period 1980-1994, it contributed almost two thirds of the observed growth. With respect to the second part of the question, the paper argues that economic growth also had a significant impact of poverty reduction—despite deterioration of income distribution in some

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countries. During 1980-2000, developing countries grew at an average rate of 3.1 percent per annum and head count poverty declined by 30 percent, implying much higher poverty elasticity than the World Bank estimates would suggest. Based on these, Dr. Bhalla argues that trade can claim credit for at least 50 percent of global poverty reduction—which is according to his estimate about 500 million.

5. I am in full agreement with Dr. Bhalla in so far as his qualitative propositions are concerned regarding the importance of trade openness to poverty reduction. Let me also add that, like Dr. Bhalla, I am also a bit uneasy, based on my own dabbling with poverty data in connection with my work with Rana Hasan and Yangseon Kim, about the World Bank dollar-a-day numbers. These figures seem to be somewhat overestimated. Nevertheless, I am similarly wary about attaching precise figures, as this paper does, to the contribution of trade to poverty reduction.
6. My uneasiness stems from sources that Dr. Bhalla is fully aware and must have heard many times from many people. Though I am a firm believer in the beneficial growth effects of trade liberalization, his analysis relies exclusively on a set of growth regressions. As Dr. Bhalla is fully aware, criticisms are legion that such regressions suffer from many conceptual and data problems. These results are highly fragile and one should not attempt to draw too strong conclusions based on them. And indeed, this problem gets compounded when one tries to establish a relationship between growth and trade openness. The latter variable is very ill defined and there is no suitable proxy that can adequately capture all the important dimensions of the problem. The proxies suggested by Dr. Bhalla have been duly criticized by Rodriguez and Rodrik (2000) and others for their various inadequacies. In light of this, Charles Jones, himself an accomplished contributor to the empirical growth literature, observed that cross-country growth regression is a particularly coarse tool for analyzing the contribution of trade to growth (Jones 2000). Of course, such stalwarts of trade theory as Bhagwati, Srinivasan, and Cooper have all along been vociferous in their criticism of this type of exercise. In light of these problems, one should consider the numbers from the present exercise as merely suggestive.

7. In this context, I may also note in passing that the claim of the paper that “ theory is unambiguous (trade reform can only increase growth)” is a bit exaggerated. Indeed, economic theory—quite unfortunately, in my view—is quite ambiguous on this question. Indeed, for example, the workhorse of the economic growth theory—the basic Solow-Swan neoclassical model—does not generate any growth effect from international trade. However, I must emphasize that the failure of economic theory or regression analysis to convincingly demonstrate the positive impact of trade on growth does not necessarily invalidate the existence of such relationships but merely points to the limitations of the discipline.
8. Without denigrating the importance of Dr. Bhalla’s exercise, it may be noted that it is a bit too macro and too aggregative to yield many insights about the underlying micro and meso mechanisms that are fundamental to understanding the poverty problem. I think we would have benefited if Dr. Bhalla explored those relationships at some length. What I have in mind is that how the poor small farmers, landless laborers, factory workers, small entrepreneurs—are affected by trade liberalization and through what mechanisms. By highlighting those concrete economic and social mechanisms, we could have perhaps derived more practical insights and identified concrete policies. What I have in mind is a story built on available micro studies.
9. I think with respect to trade and investment openness, few policymakers in the developing world would need further convincing of the benefits of openness. Policymakers all over the world are impressed by the miraculous economic performance of the East Asian economies. They are impressed by the rapid pace with which these economies reduced their absolute poverty, and the important role trade played in the transformation of these economies. To most policymakers, the real question now is not whether trade is beneficial for growth but how to maximize the benefit from it. They seem more interested to know what to do next. And how to go about it.
10. That the policymakers are convinced of the benefits of openness is partly reflected in the wave of trade liberalization in recent years. This can be seen in the dismantling of nontariff barriers and drastic reduction in tariff rates. By 1990, the average tariff rates of Latin

American countries have converged to the East Asian levels. Indeed, tariff levels in East Europe and Central Asia and even Sub-Saharan African countries are not too far from the East Asian average. In fact, the tariff rates in East Europe and Central Asia are below the East Asian average. Even in South Asian countries, the tariff levels have come down significantly in recent years. In 1999, the average tariff rates for Bangladesh, India, Nepal, Pakistan, and Sri Lanka were respectively 8, 15, 11, 21, and 12 percent (Srinivasan 2001). By any reckoning, these rates are not excessively high. Despite this substantial reduction of tariff barriers across the developing world, few countries have seen the type of growth and poverty reduction experienced in the East Asian miracle economies. In light of this, it is not enough for us economists to chant the mantra of trade liberalization and openness. I think we need to say more.

11. A recent examination of the East Asian development experience at ADB (Quibria 2002) suggests that trade liberalization by itself may not be enough to bring about rapid growth and poverty reduction. Trade liberalization to be economically fructuous needs to be accompanied by complimentary domestic policies and institutions. And these policies and institutions do not necessarily emerge automatically with trade liberalization. They need to be created by deliberate public actions. Some of these complements relate to macroeconomic stability, labor market flexibility, adequate physical and social infrastructure, and good governance and market-supporting institutions. These complements help contribute to the creation an environment that encourages entrepreneurs to direct their talents to production and exports than to engage in rent seeking and other unproductive activities. The failures of many developing economies can be attributed to the absence of one—or a combination—of these complementary factors. In Latin America, one might think of macroeconomic instability; in Africa, of failed political regimes and social conflicts; and in South Asia, of labor market rigidity and lack of adequate physical infrastructure (roads, ports, etc.). These are factors that have seriously hampered efforts to exploit the full potential of trade liberalization. However, creating these complements is not an easy task. But it is certainly of interest to know how the economically more successful countries have overcome these constraints and how the less successful countries can replicate the process.

12. In this connection, I might also add that the usual textbook discussions of the gains-from trade assume such idealized conditions as perfect markets and free mobility of factors. But these assumptions which lie beneath the standard results hardly exist in reality. In the real world, particularly in developing countries, there are many microeconomic constraints that hinder production efficiency –and ipso facto international competitiveness. These constraints are particularly binding in the case of small entrepreneurs in the areas of credit, insurance and marketing, and government regulations (Bardhan 2002). Removing these market imperfections can make an important contribution to enhancing the economic positions of the poor and small entrepreneurs. There is of course no reason to assume that these constraints would automatically be removed with trade liberalization.
13. Finally, I must add the while trade liberalization will in the long run lead to higher growth and poverty reduction, that may not necessarily be the case in the short run. In a recent paper, Bardhan (2002) lists a whole set of plausible circumstances under which a certain class of workers may be displaced. While trade liberalization will lead to gainers, there will also be losers at least in the short run. . Given the serious obstacles to redistributive policies, a particular concern of policymakers is how to take care of the displaced workers, especially in the face of a tight public finance situation. The situation becomes much more complicated when trade liberalization leads to short-term dips in output. This is not a mere theoretical possibility. Indeed, in a recent empirical paper, Greenway, Morgan, and Wright (2002) found that the impact of trade liberalization has a J-shaped impact. At first output falls in import competing industries but it then gradually increases as the exportable sector expands. If this is the reality in many developing countries, and if output decline is correlated with poverty increase, then it is conceivable that trade liberalization has an inverted J-shaped impact on poverty. The important concern of the policymaker in this very real situation is how to take care of rising poverty in the face of declining government revenues.
14. Let me conclude by saying: while openness to trade can displace some existing jobs and shut a few economic opportunities for the poor, it should however not make the poor worse off in the medium and long run, if appropriate complementary policies and institutions are in place. If these complementary policies and institutions are in place, then openness to

trade and investment can create new opportunities for the poor—and the lower segments of the society. However, implementing these reforms in policies and institutions demand political leadership and bureaucratic capability much beyond that available in many countries. In the absence of such leadership, acumen and capability, only openness may not be able to break the vicious cycle of poverty that Dr. Bhalla—and many of us—would like to see.

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