

FREE TRADE AND POVERTY ALLEVIATION

RESEARCH PAPER ASSIGNMENT

INTERNATIONAL POLITICS

POL 8043: GLOBALIZATION, POVERTY AND DEVELOPMENT



Paper ID: 14303643

ROBBY ACHIRUL

110523284

r.achirul@ncl.ac.uk

NEWCASTLE UNIVERSITY

2012

Ever since its introduction, the supporter of free trade continuously claim that it has helped on reducing the number of world poor population. Its renounce effect are taunted to significantly limit or even reduce the rate of poverty. The correlation between free trade and poverty in third world economies has long been debatable topic where there are many opinions and stereotype on the matter. According to Anderson (2004) scholars have different opinions on how to associate free trade with poverty alleviation. For some, free trade has been linked as a tool to generate growth in economy that in return would bring about reduction in poverty rate. While other scholars is in the view that free trade has a weak connection with poverty alleviation, or even on the contrary it cause further disbalance in income distribution and equity (Ravalion 2005; Bhattasali et al. 2004).

Evidently poverty is a challenging issue of our time. Based on World Bank optimistic calculation the world population living with less than \$1.25 a day is projected to be around 882.7 million in 2015, which is a considerable improvement compared to 1.4 billion in 2005 and 1.8 billion in 1990. Still most of the improvement is a result of China and India impressive growth, whereas many African nations are way behind. China's poverty rate is projected to decrease below 5 percent by 2015, while India is also expected to contribute significantly toward global poverty alleviation as it is projected to reduce it poor population up to 22 percent in 2015 (World Bank 2011).

Despite the fact that developing countries are the home of the world's poorest population, it significantly drives the world economy toward recovery in the aftermath of the global economy crisis. The World Economic Outlook released by International Monetary Fund (IMF) shows that after 0.5 percent reduction in 2009, the world GDP

increased by 5.0 percent in 2010, in contrast with 2009 estimation of 4.2 percent. The recovery distinctly uneven, with the emerging markets and developing countries leads few percentage points ahead the developing countries (IMF 2011). The impressive progress of the developing countries is well reflected on their growing role in the worldwide trade. Trade and output in 2010 increased more rapidly in developing countries compare to developed countries. Developing countries marked nearly 17 percent of export growth while the developed countries reach 13 percent. The margin are even higher in import, where developing countries total import increased by 18 percent compared to 11 percent increase in the developed countries (World Trade Report 2011).

While the commonly agreed presumption in favour of free trade, questions still persist of the significant role of free trade on poverty alleviation. How to exercise free trade in such way that could benefit those of poorer country on combating poverty? Thus what to do to overcome poverty that it does rise or aggravate?

This essay is focuses on emphasizing the link between free trade and poverty alleviation, thus in doing so it will review how developing countries are integrated in the global trade structure and how their participation affected their effort on combating poverty

In linguistic term the word trade refers to a lane or shaped route, meaning a regular communal function, in ancient time trade being made for essentials and rooted in other social purposes. Historian mainly comprehends trade as rigid and state driven over long period of time, while others regard dynamism and employment as integral component of trade. In general, trading is seen as socially and culturally

uncontrollable, hence compelling common idea of protection in actual meaning. Thus it can be said that trade is an ancient and natural routine, as is the common preindustrial motive to transform trading toward fundamental mannered institution, turn it to become more compliant to the community and culture (Polanyi 1957).

According to Dunkley (2008) free trade is widely stated as the absence of authority controls toward the cross border exchange of commodities and services, with slight regulation applied, though as an outcome of the growing trade complexity, policies in an increasing figure are currently being imposed which tend to put trade under restrictions and hinder efforts for liberalization. The commonly imposed barrier can be characterized as natural, market, policy and service regulation barrier.

In turn trading evolved and turns to be more enterprising, exclusive and dislodged. The early intellectuals named mercantilism emphasize it as crucial for development. Adam Smith believed that in order for trade to fulfill its potentials, it ought to be free or without any government intervention. Although Smith imply that trade must not put distress toward the community and disagree with the view that capital should transferred across border. In the late 19th century the emergence of new trading enterprise were considered crucial for industrial revolution, thus liberalization became common practice until it was latter on realized (Dunkley 2004). The historian Paul Bairoch (1972) revealed that protection is needed for ensuring growth in many states. But in present day free trade is commonly regarded as key for growth thus it is essential to the practice of trade among countries.

The essence of trade theory and is the concept of 'comparative advantage', introduced by the 19th century economist David Ricardo that postulate the benefit of trade for it allow every country to concentrate on certain commodities that they can

produce relatively efficiently. In this respect trade might bring further benefit in four ways. First free trade exposes foreign markets, increasing demand for local commodities. Second free trade provides opportunity to acquire certain inputs at lower rate and help reduce production cost. Third, free trade increase competition from foreign commodities which in turn might improve efficiency of local producers. Fourth, free trade could affect economic growth through various channels.

Despite the central assumption that trade promote economic growth, this assumption is generally incomplete as it exclude the nature of developing countries economy. The standing opinion in favor of free trade is that it increases the aggregate efficiency within a country. In practice the flow of commodities from foreign producers might jeopardize the existence of inefficient domestic industries, but other competitive domestic industries are expected to make up for the losses as they increase export to foreign countries. Under this circumstances free trade are supposed to stimulate productive inputs redeployment from less efficient sector to other efficient sector. But off course the argument made under assumption that resources are already fully utilized, while in the case of the developing countries the assumption are far from reality. Hence the corresponding policy would be to directly put the idle resources into productive use (Stiglitz 2005: 25-26).

Trade liberalization and poverty alleviation is at the heart of current time debate in worldwide forums and international organizations, and even becoming regular object of discussion amidst the larger part of the worldwide organization, central and local government all over the world. The discussion for liberalization of trade was initially started with the Havana Charter in 1940 that last for four rounds, consecutively the Dillon Round (1960-62), Kennedy Round (1963-67), Tokyo Round (1973-79), Uruguay Round (1986-93) and continues through Doha Round that started in 2001.

The common purpose on making trade free in reality are difficult to materialize, as the immense subsidy in developed countries, unbalance distribution of free trade benefits and the obscure development in Doha Round are issues that difficult to address (Abbot 2003; Finger 2002). The World Trade Organization (WTO) Doha Round was expected to be signed on the 1st January 2005. The deadlock in numbers of crucial agricultural matters, namely access to market, local support and subsidies for export commodity. In July 2006, the Doha Round was indefinitely halted after a numbers of failed efforts to achieve consent of farm subsidy, tariff and modalities (Schott 2006).

Contemporary literatures suggested that free trade and poverty reduction are positively related, although it also recognizes that the linkages are complicated. Reimer (2002) underline some main linkages concerning free trade and poverty alleviation reduction, such as the availability and price of commodities, factor prices, taxes, incentives, terms of trade transformation and risks. The conventional perspective in favor of significant correlation between free trade and poverty alleviation centers its argument on the linkages on the availability and price commodities. For example, many poor people are employed in the agricultural field in which trade bias are explicitly high. Free trade might alter global agricultural price level and in the end raised activity and remunerations in the third world agricultural sector. The similar positive outcome might also occur in the garment and textiles sectors with strict protection imposed and comparative advantage for the developing countries (Bouet 2008:3).

Despite the positive, liberalization in turn might cause negative impact. Firstly the decrease in import might lower revenues generated from custom so that the state income source would recede, which could lead to lower government transfer.

Secondly, terms of trade could be negatively inflicted, because the increase on import charges or export charges decrease as result of tight competition in world export markets. Thirdly, loosen the barrier to entry might promote import competition, which means moving of productive factors which give rise to adjustment charges and short term risk. In addition the argument of positive relationship between free trade and poverty alleviation is based on the assumption of the existence of agricultural economy in developing countries. But it undermine the fact that not all developing countries have what so called comparative advantage in agricultural sector, and further more the whole poor population does not necessarily involved in agricultural sector (Bouet 2008:3).

The positive view that free trade has significant influence over poverty is represented by intellectuals such as Anderson (2004) Collier and Dollar (2004) and Bhattasali (2004). The main beliefs behind their assumption is that free trade increase efficiency of market and production, this will generate positive benefit or surplus for the world market. The benefit in turn would fuels growth in the economy and finally contributes to poverty reduction efforts.

Bhattasali (2004) based on his study indicates that the increasing integration of developing markets into the global economy have resulted in higher income growth, increase in life expectancy and improvement of school enrollment ratio in those countries respectively. As home of some 3 billion of world population, these countries has seen its income per capita increased 5 percent in average and that is substantially higher compared to 2 percent growth in developing countries. Many of these countries like China and India have incorporated policies and institutional adjustment that enabled their population to make use of worldwide market potential and by doing so increased the portion of trade in their Gross Domestic Product

(GDP). Bhattasali added that the integration of developing countries into the world market brought positive changes in the way that it raises wages level thus lifting the people out of poverty.

The positive connection between free trade and poverty alleviation are also significant, as most of the developing countries population are low income farmer (approximately 2.5 billion persons). In this respect Jha (2004) study on the effect of free trade toward poverty imply that free trade on agricultural commodities has helped poverty reduction effort, for example in India where restrictions comprise of tariff and subsidies restrain Indian agricultural commodities to compete in the developed countries markets. Jha argued that by embracing free trade in agricultural sector alone, the developing world would then see a number of 100 million people of their population lifted from poverty. This would requires the developing countries to exercise appropriate reforms in the national level, along with capacity building to ensure the integration of the developing countries agricultural sector to the world market.

Jagdish Baghwati (2004) on his work argues that free trade might promote growth, in turn growth provide opportunity for poverty reduction to happen. Free trade mechanism for developing countries may works on two ways, firstly by allowing Foreign Direct Investment (FDI) flow through the establishment of Multinational Companies or secondly by introducing its local commodities throughout the global market in compliance with free trade terms. In theory, the present of Multinational Companies would open more opportunities in term of employment and maximizing the use of the existing natural resources. Either way is conceived to stimulate productivities within one country industrial sector. Bhagwati support his argument by exercising study on the cases of India and China where both account for large share

of the world poorest population. The transformation from inward oriented economy toward outward oriented economy is at the heart of both country success stories, as the pair regarded as countries with the highest growth rate since 1980 to 1990 even up to present (Bhagwati 2004). Recent United Nations MDGs report showed that India and China have registered the highest decrease in poverty numbers with both countries poor population projected continues to decline from 51 percent in 1990 to just 22 percent in 2015. The number of population living in extreme poverty from 1990 to 2005 has declined by 455 million people, and it is to be expected that another 320 million people would add to these number in 2015.

The argument that free trade contribute to poverty alleviation through economic growth that it generated seems to be justified when we compare Asia and Africa economic openness. During in 1970s Asian countries began to gradually open up their economy in contrast with African countries which relatively remain less integrated to global market. Asia is the home of 76% world poor population while Africa has the share of 11%, the balance shifted in late 1980s where Asia share of poor population drop to 15% in contrast with Africa which saw dramatic increase in its share reaching up to 66% from the world poor population (Bhagwati 2004).

The link between free trade and poverty alleviation thus can be described to a numbers of channels: (i) by altering the price level of commodities and increasing access to new products; (ii) by altering the factor price utilize in the production process and contributed to earning and employment of the poor (iii) influencing state revenue gained from trade tax and the state capacity to promote policy in favor of the poor (iv) altering investment and innovation incentives and influencing economic growth (v) by influencing the resilience of an economy to negative trends that might affect the poor (vi). It is worth to mention that some of the effects might works

instantly while other requires longer time. This circumstances feature the complex link between free trade and poverty alleviation, resulting obscurity on any attempt to generalize the linkage (Banister 2001).

In what account does free trade could effectively contribute to the effort of poverty alleviation in developing countries?

Bhagwati (2004) argue that the required condition to maximizing the benefit of trade for developing countries is the introduction of appropriate domestic policy that coupled trade liberalization. He added that the absence of such appropriate policy would potentially brought adverse effect; in example the failure of one country to control the export of certain commodity would eventually bring damaging effect of falling commodity price due to excess of supply in the world market. Strategically domestic policy could also comprise of providing access for financial credit to the middle class population to further stimulate the economy through the creation of entrepreneurship.

Stiglitz (2005: 1-2) in this regard state that policies on trade both in developed and developing countries can be directed with the purpose to help developing countries to integrated itself within the global trade system, and ensuring that they would gain benefit for taking part. In the appropriate conditions, some policy that reduces barriers to the transfer of commodities and services can intermediate trade among nations and bring welfare benefit. Stiglitz also reiterate that despite the benefit it can bring for developing countries, free trade system must be managed properly than simply encourage developing countries to fully integrate into the free trade system.

In opposite with the optimistic view that free trade has significant effect toward poverty alleviation, there are other intellectuals argue otherwise if not obscure.

Bhattasali (2005) is among those who determine that the correlation need to be further assessed. Bhattasali findings showed that while the claim of distinct correlation between free trade and poverty seem to be true in some countries, it does not necessarily true in general. Not every country is in the state of successful integration with the global market, whereas as much as 2 billion people living in the less integrated country. In general these countries have contracted, experienced increasing number of poor population added with lower education improvement compared with those of the more integrated countries (Collier and Dollar 2004). As Twyford (2003) state that the effect of free trade on poverty rate are rest upon various factors , such as the distribution of income and assets, the type of commodities that the poor population create, bought and sell, and the competitiveness level of the national producers.

Stiglitz (2005) in particular underline the fact that the majority of the model that designated to answer the questions of welfare gains generated from free trade are based on the wrong assumption of full employment. Hence they fail to explain the effect of free trade for economies under employed resources, which is a natural feature of the developing countries economy. Stiglitz also added that the most concerning issue for developing countries to fully participated into the world trade system is that free trade might lead to increased unemployment (Stiglitz 2005: 25-26).

Madeley (2004) argue that currently the role of free trade system on poverty is in greater doubt, particularly for the case of the low income agricultural oriented economies. The benefit of free trade is likely to be restricted. In the early 21st

century free trade system seem to less effective on helping the world poor to come out of poverty. Furthermore trade free trade and the international rule imposed seem to have inflicted damage on most of the poor population and the environment of the developing countries (Madeley 2004). Abbot (2004) states that the free trade structure is distorted and not in favor of the poor. The developing countries faces even higher trade barriers in term of tariff compared with the developed countries does. Different political preferences that behind the developed countries trade policies cause inequality between developing countries.

Ravallion (2005) also emphasize the insubstantial correlation between free trade and poverty alleviation. His finding is based on quantitative method to investigate the presumption that free trade cause a lot more suffering rather than helping the poor population in developing countries. He examine series of data on poverty population across countries suggest that there is the correlation between poverty decrease and extended trade volume is rather weak. Therefore Ravallion conclude that the general assumption that free trade are powerful tool for poverty alleviation in developing countries are irrelevant.

Based on all the studies and argument being made out, it can be concluded that the debate concerning the influence of free trade on poverty alleviation is far from over. As Twyford (2003) states that the conclusion on how exactly free trade influence poverty alleviation is still mixed. The idea of one global market is 'neither inherently good nor inherently bad for poverty reduction'.

The correlation of free trade and poverty has been an object for numerous studies over the years. The resulting conclusions commonly differ from the theoretical background, approach, the nature of the nations/region under studies. The differences are not limited to the magnitude of the relationship, but including the course of the correlation. The difference of result among the studies can be used to identify into two categories, namely those that perceive free trade has positive impact toward poverty alleviation and those that are in question of the significance correlation between trade and poverty alleviation.

In deep review on the studies of the correlation between free trade and poverty alleviation provide that the results vary, thus the linkage between free trade and poverty are not consistent. It is not only the degree considered, but also the meaning of the correlation is also factious. Meantime, free trade is generally emphasized as inflicting negative effect on equality, or at least ambiguous influence. Growth or in some cases agricultural growth is mainly considered to have positive correlation with poverty alleviation. While this is generally true for the case of the countries that experiencing highest growth rate, the biggest contributor of poverty alleviation are not always associated with growth itself. Other factors also need to be put into consideration, such as the initial rate of income inequality and assets distribution and evolution.

Wide range of studies has indicated that the effect of domestic decision on free trade is important. To ensure the world's poor gain the most benefit out of free trade, it is essential for the government in national level to promote pro-poor policies to coupled free trade measures. The pro-poor national policies that would ensure the poor population gain benefit from free trade in general comprise of; introducing investment in certain sectors that would bring more benefit for the poor population; increasing

access to land/assets and exercising pro poor employment to expose the potential benefit of free trade to the area with the poorest population.

For many of the developing countries the question on whether they could truly benefited from free trade system remain significant, the issue is also about how to integrate into the world free trade systems. What need to be done before they fully integrated. According to Stiglitz (2005 :39-40), as the developed countries central role in the global trade decisions making, they ought to responsible on shaping the global trade system that enable the effective integrating of the developing countries. They also expected to revise their trade policies to further increase trading possibility for developing countries.

BIBLIOGRAPHY

Abbot, K.W. (2003). Development Policy in the New Millennium and the Doha Development Round, Asian Development Bank. Manila: ADB

ADB (2004). Key Indicators 2004: Poverty in Asia. Manila: ADB

Anderson, Kym (2004). Agricultural Trade reform and Poverty Reduction in Developing Countries, World Bank Policy Research Paper. Washington: World Bank

Bannister, Geoffrey and Thugge, Kamau (2001) International Trade and Poverty Alleviation, IMF Working Paper, issues 2001-2054. Washington: IMF

Bhagwati, Jagdish. 2004. Poverty: Enhanced or Diminished?, In Defense of Globalization. Oxford: Oxford University Press.

Bhattasali, Deepak et al. (2004). China and The WTO: Accession, Policy Reform and Poverty Reduction Strategies. Oxford: Oxford University Press

Bairoch, Paul (1972)

Bouet, Antoine (2008). The Expected Benefits of Trade Liberalization on World Income and Development. Washington: International Food Policy Research Institute

Collier, P and Dollar, D (2002) Globalization Growth and Poverty: Building an Inclusive World Economy. Oxford: Oxford University Press

Dunkley (2004). Free Trade: Myth, Reality and Alternatives. New York: Palgrave Macmillan

International Monetary Fund (2011). World Economic Outlook. Washington: International Monetary Fund

Jha, Nedumpara (2004). Poverty Impact of Doha: India, the Doha development Agenda, Impacts on Trade and Poverty. London: Overseas Development Institute

Madeley, J (2004) Trading off the Poor: People and the Planet 2000-2004. <http://www.peopleandplanet.net/doc.php?id=1525§ion=16>

Polanyi, Karl (1957). The Great Transformation of Our Time. Boston: Beacon Press

Ravalion, M (2005). Looking Beyond Averages in the Trade and Poverty Debate. Research Paper No. 2005/29. Helsinki: University of Helsinki

Reimer, J. J. (2002). Estimating the Poverty impacts of trade liberalization. GTAP Working Paper 20. West Lafayette, Ind., U.S.A.: Center for Global Trade Analysis, Purdue University.

Schott, (2006). Completing the Doha Round: Policy Briefs in International Economics, No PB06-7, pp 1-8. Washington: Peterson Institute for International Economics

Stiglitz, Joseph (2005). Fair Trade For All: How Trade Can Promote Development. Oxford: Oxford University Press.

Susila, Wayan (2008). Effect of trade Liberalization and Growth on Poverty and Inequity: Empirical Evidences and Policy Options. Agro Economic Forum Vol. 26 No.2 . Bogor: National Agricultural Research Institute

Twyford, P (2003). Does Trade Liberalization Exacerbate or Reduce Poverty? Trade and Globalization in the Lead Up to the Cancun Ministerial, Address to Council for International Development Trade Forum. London: Oxfam International

World Bank (2011). Global Monitoring Report 2011: Improving the Odds of Achieving MDGs. Washington: World Bank

World Trade Organization (2011). World Trade Report 2011: The WTO and Preferential Agreements. Geneva: World Trade Organization