

IS FREE TRADE HELPING TO END WORLD POVERTY?

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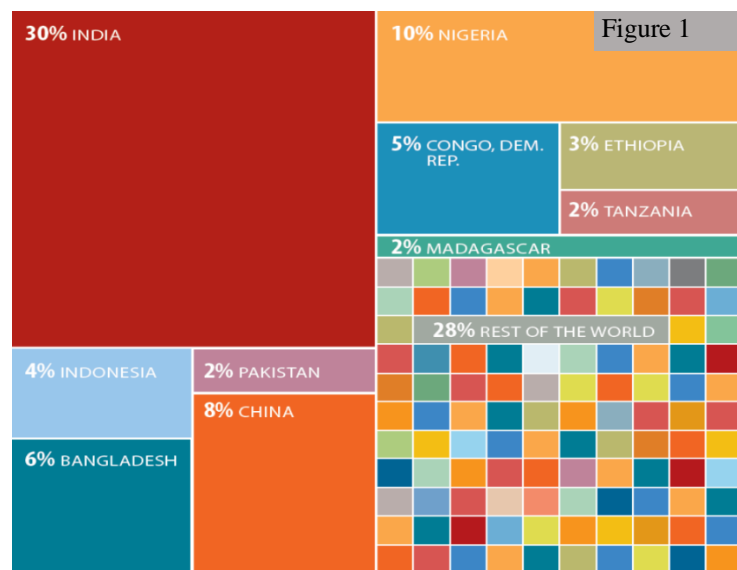
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This paper will explore the question of “Is free trade helping to solve world poverty” which comes from the textbook Taking Sides by Stephen Hill.¹ The first half of the paper will look at both the pro side of the argument supported by publications from the World bank and others, and then at the con side represented by articles from Ian Fletcher. The second half will then focus on my own opinion on the topic and explore specific examples of trade reducing poverty in the world and try to look at the question in a nuanced way.

According to the World Bank Group and the World Trade Organization the expansion of international trade has been essential to the reduction of poverty. Their 2015 joined report argues that deepening economic integration between states and bringing down the cost to trade is an absolute must for eliminating poverty and ensuring strong growth especially for developing states.² The report starts out by identifying where poverty is concentrated in the world and how it plays out in these areas. Most of today’s extreme poverty³ is located within the regions of Sub-Saharan Africa and South Asia. Many of them live in rural areas and make their livelihoods through informal sectors⁴. Opening up to trade can help address this issue by spurring up economic growth in the area. This allows states to specialize in the production and supply of goods & services that can now be produced more cheaply and efficiently due to the access of imports and the potential



of exporting it. This can happen due to multiple factors; First let’s look at the exchange of technology, innovation, and knowledge with an increase in trade. Developing states can jump start industries and vastly improve existing ones simply by gaining access to the knowledge of industrialized countries. For example, in the agriculture business learning ways to increase

¹ Hill, “Is Free Trade Helping to End World Poverty?”

² World Trade Organization, *The Role of Trade in Ending Poverty*.

³ World Bank defines extreme poverty as less than \$1.25 a day

Figure 1 Percentage of global extreme poor in each country

⁴ Also known as shadow economy; Workers are not regulated, don’t declare income, and don’t pay taxes

production and efficiency by maybe using a different way of irrigation can be revolutionary. Second, gaining access to an entirely new market of supplies will allow you to grow massively. Sticking with the agriculture example, farmers now having access to new seeds, chemicals and other products at cheap prices will allow them to expand their business, hire more people and drive up the income in the area. Having now access to even entire brand-new products like animal vaccines and machinery will also allow for sustainable growth. Thirdly, more trade will allow for additional competition which should reduce the prices of commodities and undermine domestic mono-and oligo-polies which will benefit the poorest consumers who should now be able to afford basic products in tune with a wage increase due to better jobs and industries. Competition also helps domestic producers by increasing the returns on efficiently produced commodities by competing against other states. These claims are derived from observations of LDCs⁵ and specific examples in these countries. Analysis of the US-Vietnam trade agreement showed that the provinces most effected by large cuts in traffic had the biggest reduction in poverty and great economic growth. This has caused opportunity to flourish which allowed people reallocate from informal sectors to formal sectors and places of employment.⁶ These reports concluded that trade makes an essential contribution to delivery the economic growth necessary to end poverty. It does so by allowing new opportunities for jobs, lowering prices of commodities, opening access to external markets, and bringing structural changes to the economy which allows for an increase in employment.

Ian Fletcher part of the Coalition for a Prosperous America argues that free trade just hasn't worked out in reducing poverty and just helped out the already successful enterprises of prosperous states. He states that most third-world countries don't have big enough economies to actually take advantage of free trade to any meaningful extent, rather the biggest winners are going to be states that are populous and already on the rise like China, India, Brazil, and Mexico.⁷ Industries from economically established nations make huge benefits by being able to now sell products in nations that were previously blocked or uncompetitive due to tariffs. This will result in impoverished nations hurting because they have no real competitive industries to compete with and if they do, they won't be anywhere near powerful enough to compete with the

⁵ Least developed countries according to UN

⁶ World Trade Organization, *Trade and Poverty Reduction*.

⁷ Fletcher, "Free Trade Isn't Helping World Poverty."

new importing firms. Nations like China have gained from increased trade due to certain different factors. First China has gained a lot of growth from the openness of the United States and the rest of the world to trade with it. Secondly, they made sure to never fully enter into free trade but use mercantile policy to carefully manage trade as to not hurt its own growth and industries. This has allowed China to lift out millions of people out of poverty which has mostly been contained to metropolitan areas, and rural areas are still struggling even with China's trading approach. In an updated article Fletcher engages with the claim that free trade optimizes industries that countries are natural good at.⁸ He pushes back against the idea that this is good. The point of industrialization and economic growth is becoming good at developing and producing all kinds of products to sustain your state. Instead, Fletcher says poor nations will be locked into certain industries with low-wage and exploitive extraction due to free trade with no protectionism. Which will only lead to a cycle of economic gains for international firms and the reduction in economic improvement for the domestic population.

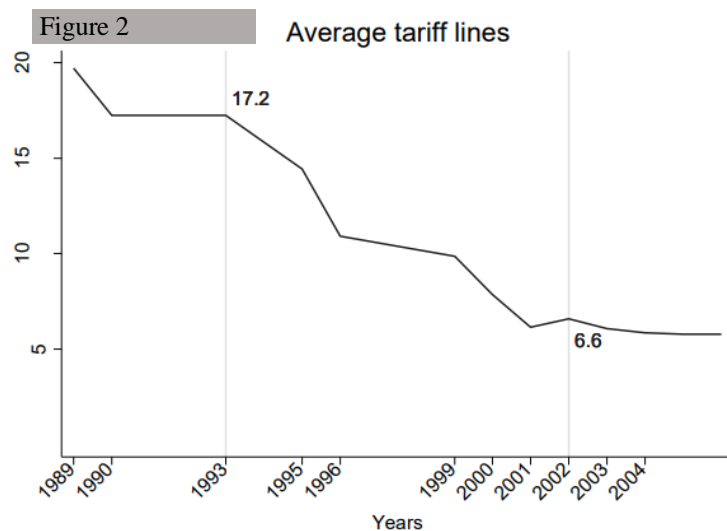
Onto my opinion on the topic, I think that in generally free trade is very helpful in reducing poverty and pushing economic growth. Now with that said we also need to keep in mind some of the arguments for protectionism as they hold some truth and free trade can be done wrong or in a vacuum cause more harm to certain population groups. According to a Harvard paper on economic development there are 3 main pillars that can play into a state's economic situation.⁹ First and foremost is geography, this has massive impacts on a state based on characteristics like climate, access to natural resources and transportation. These factors play massively into trade as a state that has for example a good number of natural resources and access to the ocean will accel with trade liberalization way more than a state that might be land locked and has no valuable natural resources. Second is trade in itself, as the World Bank and WTO argue having access to trade alone is already very beneficial to a developing country by giving it access to the international market for example.¹⁰ Later on we will look at specific cases from Africa to Asia that is evidence to support this idea of trade and especially free trade. The third pillar are institutions and their role in the state. If a state has a strong rule of law and regulations than opening up to trade will be way more successful as more parties want to trade

⁸ Fletcher, "No, Free Trade Didn't Lift Millions Out of Poverty."

⁹ Rodrik, Subramanian, and Trebbi, "Institutions Rule: The Primacy of Institutions Over Geography and Integration in Economic Development."

¹⁰ World Trade Organization, *The Role of Trade in Ending Poverty*.

with that state and economic gains aren't lost to corruption and illegal behavior. The 3 pillars demonstrate that yes trade liberations on their own can be great in reducing poverty and bringing up a state in most cases but that in combination with other factors like geography and institutions, a free trading society will even prosper more. Now let's look at some specific examples of trade reducing poverty. First, we jump to Indonesia, here a group of researchers studied 259 Indonesian regions from 1993 to 2002 and measured the effects of tariff reductions over the years.¹¹ This figure shows the average amount of tariffs reduced over the time span studied. By the 2000s Indonesia already had less than 5% in most industry categories but



specifically wood, textiles and food were still around 10% propping up the average. The researchers found that during the period of tariff reduction most districts saw a strong reduction in poverty even with a temporary setback due to the 1997/98 economic crisis in that region. They suggest that trade liberalization has contributed

partially to reduction in poverty across the country by increasing the income of the poorest population groups. While they found no massive reduction in poverty head count, they found that the depth and severity of poverty seemed to be reduced massively. They also found no evidence of domestic firms losing ground to international ones but rather they became more competitive, hired more workers and increased wages. Next, we jump to Senegal, here researchers set out to study the specific effects of trade liberations and standards on the vegetable export chain.¹² The previous study looked at all sectors on a macro level, whereas in this study they are looking at the micro effects of opening trade up on a specific industry. The researchers found that increased open trade let to a healthy grow of FFV¹³ exports in the country, including to regions like the EU where health and safety standards are high. Claims have been made that these standards could

¹¹ Kis-Katos and Sparrow, "Poverty, Labor Markets and Trade Liberalization in Indonesia."

Figure 2 Average reduction in tariff percentage across industries in Indonesia

¹² Maertens and Swinnen, "Trade, Standards, and Poverty: Evidence from Senegal."

¹³ Export-Category: Fresh Fruits and Vegetables

have bad effects on poor people and smaller businesses, but the study found the opposite. The increased standards actually lead to a complete supply chain restructure in the region which elevated the labor market. This allowed for more positions, safer work environments and higher wages for people working in the FFV industry. This in turn had a significant effect on poverty in the country, especially rural households that gained economically due to in massive increase in estate farm employment. Most of the FFV industry consisted of contracting farms as you can see in Figure 33. This has increased overtime

but taken a fall due to a massive increase in estate farms which are now becoming viable due to the openness of trade and therefore the opportunity to export.

While a small group of contract farmers might lose out economically because their small farms aren't viable anymore the overall gains of made by all parties

overshadows this, especially since those farms where of higher economic standing than the lowest poverty group anyway which gains massively from estate farms. This research specifically highlights the gains made on the labor market sides and argues that these are even more important than the access to the international goods market. Lastly, we will look at a comprehensive analysis of African countries over a three-decade period to see the impact of trade on poverty.¹⁴ The researchers are tracking 30 different countries and are measuring their openness and engagement to trade relating to their poverty statistics. The results mirror what the over studies have shown, countries that opened up more to trade and reduced tariffs saw reductions in poverty and high economic growth, though while comparing the gains of different states the researchers noticed large variations of gains between states, they came to the same conclusion as the first study in that trading is an important tool in reducing poverty but it wont work great in vacuum. Countries that had better economic activity, education levels and bureaucracy scores were able to capitalize way more on the gains of trade liberations and therefore made the biggest step in poverty reduction.

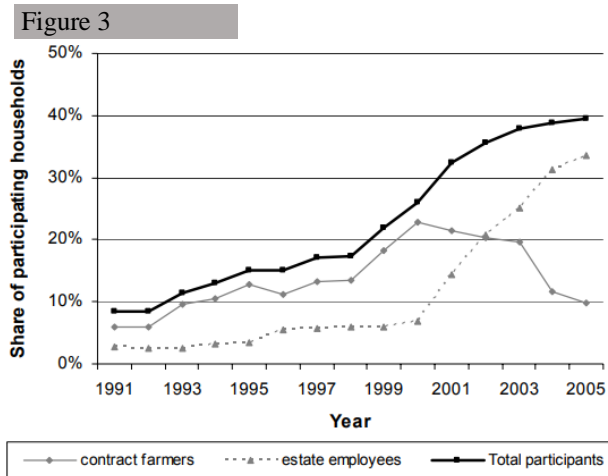


Figure 3 Household participation in French bean (FFV) export production in Senegal, 1991-2005

¹⁴ Le Goff and Singh, "Does Trade Reduce Poverty?"

Overall, most sources presented here, agree that free trading is a massive tool to help reduce world poverty. It is not a magic bullet, and it could be counter productive in certain instances if done wrong. For example, the research showed that opening up trade had way more of a poverty reduction affect in states that had better institutional scores in areas like corruption and education. Also, there is little research on going from a closed off state to a free trading state with everyone, most cases suggest that opening up trade over time and working your way towards free trade gives the most benefit and can help protect some of the negative aspects of trade that could happen like Fletcher brings up. To end the paper, the answer to the question “Is Free trade helping to solve world poverty” is yes but there are a bunch of other factors that have to be taken into account.

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