Trade Liberalization and the Poor: A Framework for Poverty Reduction Policies With Special Reference to Some Asian Countries including India

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Abstract

The paper examines the impact of trade liberalization on the poor through its impact on prices and incomes .A simple framework is given which traces the impact of trade liberalization on the poor. There is unambiguous empirical evidence from economies around the globe and for some of the Asian economies included in our sample that trade openness promotes economic growth. Raising economic growth in a sustained manner reduces poverty. Further, for cross section of fourteen Asian economies included in our study no significant relationship could be found between changes in inequality and poverty, and inequality of incomes with economic growth rates and trade openness .However, most of the poor in the developing economies are in the agricultural sector, therefore raising growth in the agricultural sector is essential ingredient for making the reform process successful. The paper closely examines the benefits of the globalization process as manifested by the unilateral trade liberalization efforts of some South Asian countries included in our study. Some guidelines are given for making trade work for the poor after identifying how the trade regime works. These provide a benchmark against which to judge the prevailing trade regime and provide guidance for the direction of reforms for the poor in future.

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I.Introduction:

One of the most prominent features of the world economy over the last fifty years and particularly in the last twenty years, has been the liberalization of international trade and payments, due to unilateral and regional liberalization efforts, & multilateral liberalization under the auspices of the GATT(and now the WTO),the IMF and the World Bank. This is one of the reasons that world trade has grown nearly five times faster than world output . However, still some developing economies like India have minimal share in the world trade (less than 1% of the world trade).The purpose of this paper to explore some aspects and consequences of the liberalization process that affect the overall economic performance of countries and welfare of peoples within countries . Trade liberalization involves reducing tariffs and non-tariff barriers with move towards non-discriminatory policies against foreign suppliers of goods and services. This is achieved not simply by eliminating quotas and reducing average tariffs and dispersion across tariff, but also by strengthening trade related institutions in particular customs and standards bodies. In general, liberalization refers to all measures taken to reduce anti-export bias and import controls , including non-tariff barriers and exchange rate distortions.

Proponents of globalization argue that greater integration with the world economy as manifested by unilateral trade liberalization efforts of some South Asian countries like India may reduce poverty. The two mechanism usually identified in this context are:first ,that reduced industrial protection should turn terms of trade in favour of agriculture and thereby raise agricultural(and rural) incomes; and, second, that this should increase industrial employment, since comparative advantage would favour labour intensive ,manufacturing in regions with abundant labour. The paper examines the two hypothesis in context of some South Asian countries including India.

There is ample empirical evidence that trade liberalization and openness to trade increases growth rate of income and output(Sachs &Warner , 1995 ,Dollar ,1992 ,Edwards ,1993, 1998,Ben David,1993,Frankel and Romer 1999,among others).Also, the link of overall growth to poverty alleviation has been demonstrated both in cross country analyses(Dollar and Kray,2000) and for individual countries[2].Trade liberalization can therefore be expected to help the poor overall given the positive association between openness and growth. The paper tests the hypothesis that whether trade openness promotes growth for fourteen Asian countries included in our sample. The study also examines the impact of economic growth rates, trade openness and inequality of incomes on poverty for the sample of Asian countries included in our study. The economic significance of economic growth rates and trade openness on inequality of incomes is also measured. Cross-country regression is used for analysis.

The paper provides the basic elements of a good trade policy regime and how it can work for the benefit of the poor. These can provide a benchmark against which to judge the prevailing trade regime and provide guidance for the direction of reforms for the poor in future.

The paper is organized as follows. Section I closely examines the benefit of the globalization process for some South Asian countries included in our study. Section II discusses the linkages between trade, trade policy and poverty. A framework is , however, given to examine the impact of trade liberalization on poverty through its impact on prices(and hence consumption) and income(Production).Section III reviews some literature which links trade liberalization with economic growth rates, poverty and inequality. Section IV gives empirical evidence between

[2] For example, Srinivasan (2000) found that of the 17 percentage point reduction in the population below the poverty line over some 40 years(between 1951-55 and 1993-94), a 15 percentage point reduction is to be attributed to growth and 2 to redistribute policies. Agricultural and rural growth in a sustained manner is though important.

poverty and economic growth rates, trade openness and inequality of incomes for cross section of fourteen Asian countries included in our study . Section V discusses the various trade policy instruments which can work for the benefit of the poor.Section VI give some general guidelines for poverty reduction. The last section gives some conclusions.

I:Gains of Globalization

Greater integration with the international economy may reduce poverty through two routes- terms of trade effect and employment effect. The two mechanisms usually identified are:first ,that reduced industrial protection should turn terms of trade in favour of agriculture and thereby agricultural(and rural) incomes; and, second, increase industrial employment, since comparative advantage would favour labour intensive manufacturing in regions with abundant labour.Sen(2003) notes that reduced protection to industry in South Asian countries have not been able to raise agricultural terms of trade.He notes that agricultural terms of trade have actually worsened in Bangladesh,Pakistan and Nepal..

The domestic policies regarding food subsidies and price support in India and Sri-Lanka, however, has raised cereal prices and thus improved terms of trade (cf Table I below)

In the South Asian Region it is services that gained from the shift in the terms of trade against manufacturing, suggesting not only that skill differentials increased but also considerable part of the dividend from reduced tariffs was retained by trade and finance. Despite overall GDP growth being maintained or slightly improved the growth of agricultural GDP decelerated throughout the region (Table II). This combination of slower output growth in agriculture with deteriorating terms of trade is the major reason why rural incomes in South Asia have tended to lag behind urban incomes. Globalization would have had greater effect if agricultural growth would not have lagged due to falling terms of trade, low technology diffusion and cuts in public investment including investment in rural infrastructure,public irrigation,roads and power.

As far as employment is concerned there is complicated picture among the South Asian countries (Table III below).It is true, for example, that garment exports and employment has expanded rapidly,particularly in Bangladesh and Sri-Lanka, but in both countries this occurred alongside significant decline in employment in other import substituting industries.In Pakistan, manufacturing as a whole experienced a severe slowdown.In India,the 1990s patterns is more complicated with manufacturing employment stagnant in unorganized sector(covers approximately 93% of the employment), but a marginal increase in employment in organized firms after reforms.(Tendulkar,2000).However,data from labor surveys by ILO show that industrial employment in India had declined in the late 1990s(cf Table III)

Table I:Sectoral Price Relatives to Overall GDP Deflator

	1979 (Ag)	1989 (Ag)	1998 (Ag)	1979 (Man.)	1989 (Man.)	1998 (Man)
Bangladesh	100	83.5	85.8	100	101.4	95.4
India	100	107.0	119.1	100	101.4	90.5
Nepal	100	82.2	86.6	100	92.7	94.5
Pakistan	100	116.0	104.0	100	95.7	91
Sri-Lanka	100	109.9	121.0	100	95	81.7

Source:World Bank Country Tables,2000

Table II:Growth Rates of Sectoral GDP

	1980s (Agriculture)	**1990s (Agriculture)**	**1980s (Industry)**	**1990s (Industry)**	**1980s (Services)**	**1990s (Services)**
Bangladesh	2.7	1.6	4.1	7.3	5.4	5
India	3.4	3.1	6.6	6.5	6.7	7.5
Nepal	3.8	2.4	8.5	7.4	3.5	6.3
Pakistan	4.6	4.4	7.3	4.3	7.2	4.5
Sri-Lanka	3.5	2.1	5	7.1	6.5	5.6

Source:World Bank Country Tables,2000

Table III.Sectoral Distribution of Employment

		Bangladesh	India	Pakistan	Sri-Lanka
Agr.	Early 80s	57.1	68.7	52.7	45.9
	1990	66.4	62.1	47.5	41.4
	Late 90s	63.2	63.9	50.0	35.1
Industry	Early 80s	12.1	13.8	18.9	18.6
	1990	13.0	15.5	19.1	25.7
	Late 90s	9.6	14.3	16.7	22.4
Services	Early 80s	26.4	17.5	28.4	29.3
	1990	16.2	22.3	33.4	29.6
	Late 90s	25.0	21.8	33.3	38.8

Source:ILO,KLIM data set from Labour Force Surveys

11.1 Trade,Trade Policy and Poverty

It is useful to consider the linkages that exist among trade, trade policy, and poverty. In a comprehensive papers on this topic, Winters (2000 a,b) identifies several key linkages, which are reiterated in large part by Bannister and Thugge (2001). Potential links include changes in:

(a) the price and availability of goods;
(b) factor prices, income, and employment;
(c) government transfers influenced by changes in revenue from trade taxes;
(d) the incentive for investment and innovation, which affect long-run economic growth;
(e) external shocks, in particular, changes in the terms of trade;
(f) short-run risk and adjustment costs.

Our paper develops a framework linking trade with poverty using link (a) and (b)(see section II.2 below)

Linkages (b) through (f) tend to be less frequently considered. A study by Levin (2000) focuses on transfers, link (c). A number of economy-wide analyses account for terms of trade effects , link (e).The factor price, income, and employment link (b) may have the greatest relative importance of all the links between trade and poverty. Household survey data as well as casual observation suggest that people tend to be much more heterogeneous with respect to income than with respect to consumption. In order words, two households may have identical commodity budget shares, and same level of income, but entirely different sources of income; one derives all income from agricultural labor, while the other relies on transfers from a relative who works abroad This point is underscored by the fact that opposition to free trade initiatives often arises from groups with highly specialized income, such as steel workers and sugar farmers in the U.S ., to name just two examples.

Within the world of classical trade theory, income effects are key to the famous Stolper-Samuelson theorem, which relates international trade to the domestic distribution of income . By the Heckscher-Ohlin theorem, a country has a comparative advantage in the good that intensively uses the country's relatively abundant factor. Free trade will increase the relative price of that good and so, by the Stolper-Samuelson theorem, increase the real return of the relatively abundant factor by an even larger percentage. At the same time, trade will reduce the return to the relatively scarce factor, though to a smaller degree. As a result, it can be said that changes in commodity prices due to trade liberalization magnify the resulting changes in factor prices.

The presence of this Magnification Effect.(due to Jones, 1965) in theoretical trade models is one reason why trade economists tend to focus on factor market effects when analyzing trade liberalization and poverty. Some (e.g. Winters, 2000 a,b) have argued that the practical relevance of the Stolper- Samuleson/Magnification result is negligible, since it rests on so many restrictive assumptions as to be a special case. Nevertheless, this theoretical insight underscores the importance of considering factor earnings effects when examining the relationship between trade liberalization and poverty.

Three empirical studies reinforce this view. A general equilibrium analysis of technical change in the Philippines by Coxhead and Warr (1995) found earnings effects to be substantially more important than consumption effects. In particular, income effects accounted for two-thirds of poverty alleviation when there was a rise in agricultural productivity.The nature of the shock is not dissimilar since the adjustments are transmitted through commodity and factor markets. Harrison, Rutherford, and Tarr(1996) find that factor price changes drive the incidence of trade liberalization in Turkey. They demonstrate this by employing three counterfactuals in which the 40 representative households in the analysis (differentiated by rural/urban orientation and by income level) have (i) identical consumption shares, (ii) identical factor income shares, and then (iii) identical consumption and factor income shares. Since counterfactual (i) provided nearly identical results to those generated when the heterogeneity of the 40 households is left intact.The authors conclude that "clearly, for the poor it is the source of income, not the pattern of expenditure that is driving the adverse impact relative to the average household" (p. 12).

A general equilibrium analysis by Warr (2001) of Thailand's proposed rice export tax also suggests that factor earnings effects are the driving force behind welfare and distributional effects. Although an export tax generates government revenue and lowers the price of rice for consumers, it also lowers the return to unskilled labor, which is used intensively in the Thai rice industry. Because both the rural and urban poor derive more than 40 percent of their income from unskilled labor (according to the Thai survey upon which the stylized households are based), the negative income effect ends up outweighing the consumption benefit, such that both the rural and urban poor are harmed by the export tax.

Despite the apparent importance of factor earnings effects, they are often not accounted for in studies that quantify the effects of external shocks on the poor in developing countries, This is particularly the case for analyses based on detailed household surveys. Because abstracting from this particular linkage may be quite misleading, this paper will pay particular attention to how each analysis deals with the income side of the story. It can be argued that many of the poor are subsistence farmers and largely disconnected from markets, or that their well being is largely determined by their net trade position in a food commodity such as rice. Studies that explore this latter issue in more detail include Ravallion (1990) and Ravallion and van de Walle (1991). As to the importance of thinking about a household's income in terms of commodities versus factors, Cranfieid,Hertel, Preckel, , and Ivanic (2001) provide interesting survey evidence on this issue for seven developing countries in Figures 1-21 of their paper.

Further,greater integration with the international economy may reduce poverty through two routes.The first relates to terms of trade effect(link e above) and the second is through

employment effect(link b above).The two mechanism usually identified in this context are:first ,that reduced industrial protection should turn terms of trade in favour of agriculture and thereby agricultural(and rural) incomes; and, second, that this should increase industrial employment, since comparative advantage would favour labour intensive ,manufacturing in regions with abundant labour.

II.2Trade Reform and the Poor:A Simple Framework

In order to provide a overview of the various possible effects of a trade policy reform we follow Hoekman,et.al(2001a).The model assumes three types of sectors:those producing import-substitute goods(M),exportable goods(X) and non-tradable or home goods(H) as well as two factors of production,labor and capital.The only asset of the poor consists of labor,while the asset owned by non-poor is capital.
The effects of trade policy reform on the poor depend on the consumption and production of the poor in these three sectors.The effects also differ in the short and long run.In the short run,factors of production are immobile,while they are mobile in the long run.

The model assumes that countries have no power to affect world prices of trade goods and that labor markets functions efficiently i.e. nominal and real wages are flexible.Domestic prices of M(Pm) and X(Px) depend on their world price and on policy variables such as exchange rate and import tariffs.On the other hand the price of H (Ph) is determined fundamentally by domestic supply and demand.In the long-run resource allocation depends on relative prices only,such as Px/Pm and Px/Ph.With three nominal prices,there are only two independent relative prices.For instance choosing Px/Pm and Px/Ph,the third relative price(Pm/Ph) is obtained by by dividing Px/Ph by Px/Pm[3].
Trade liberalization(a reduction in tariffs) raises Px/Pm,and labor and capital have an incentive to move from M to X.Whether Pm falls or Px rises makes an enormous difference in the short run and is likely to determine the success of the reform.This is where complementary policies play crucial role,including exchange rate policy.
Suppose the nominal exchange rate (ER) remains unchanged following a tariff reduction. Then Pm falls while Px remains unchanged, and labor and capital in sector M are hurt in the short run. The groups that are hurt are likely to lobby for a policy reversal. Also, though in the long run both imports and exports increase with a tariff reduction, imports tend to increase faster than exports, with a likely deficit in the balance of trade that may be unsustainable. Both the pressure from short-term losers and the balance of trade problem may result in a failure of the reform. This outcome can be avoided or its effects are mitigated by depreciation of the domestic currency. This raises the price of importables relative to non-tradables, and helps dampen both the increase in import demand and the decline of labor and capital's nominal income in sector M. On the other hand, labor and capital in sector X benefit from the devaluation since Px increases[4].

Thus, a policy package of tariff reduction and currency depreciation should make it easier for the factors of production in sector M in the short run and during the transition period, and should dampen the resistance to the reform. In countries with a flexible or floating exchange rate policy, the lower tariff will raise the demand for imports and for foreign exchange. This will raise the

[3] With three nominal prices, there are only two independent relative prices. For instance, choosing Px/Prn and Px/Ph, the third relative price (Pm/Ph) is obtained by dividing Px/Ph by Px/Pm.

[4] A devaluation has no impact on the relative price Px/Pm because both prices increase in the same proportion.

price of foreign exchange or lower the value of the domestic currency. In other words, the exchange rate will depreciate (more units of domestic currency per unit of foreign currency). This is similar to a devaluation except that it is determined by the market and not by the monetary authorities.

The effect of trade reform on the poor also depends on the second relative price Px/Ph. That relative price depends not only on policy but also on consumer reaction to the policy since it is determined by supply and demand. Px/Ph also rises following a tariff reduction, though less than Px/Pm.

When the value of the nominal exchange rate cannot be changed, a tariff reduction has no impact on Px but lowers Pm. This leads to a shift in consumption from H and X to M, and thus to a reduction in Ph (though less than the reduction in Pm). This implies an increase in Px/Ph. With a full devaluation equivalent to the tariff reduction, Pm remains unchanged and Px rises by the magnitude of the depreciation, shifting consumption from X to M and H, raising Ph. Px/Ph rises by the exact same amount as in the absence of devaluation. Finally, with flexible exchange rates, the depreciation is less than the reduction in the tariff, so Pm fails, while Px rises. Consumption shifts from X to H and M, and from H to M, so the net effect on the demand for H is ambiguous, as is the effect on Ph. Note, however, that Px/Ph rises exactly as in the other two cases.

Effects on Real Income in the Short Run

The impact of trade reform on the poor in the short run will critically depend on their location in terms of consumption and production (income), in particular whether they are employed in tradable or nontradable activities. There are three cases to consider that indicate the types of effects that may arise:

i) Poor employed in the exportable sector. The relative price of sector X increases. Thus, in the short run, as factors are not mobile across sectors, the wage rate of labor employed in X increases. On the consumption side, labor (and the poor, by assumption) would gain as long as they consume either some M or some H or both (since their prices fall). Thus, labor's real income must improve; and the higher the proportion the poor spend on H and M, the larger the gains. Thus, the real income of labor in X must rise, or remain unchanged in the unlikely circumstance that the poor spend their entire income on the exportable X.

ii) Poor employed in the importable sector. If, on the other hand, the poor produce in the importable sector, a tariff reduction would lead to a decline in the wage of the poor (labor) employed in the importable sector. How much they would lose then would depend on the consumption effect: if they spend all their income on importables, the income and consumption effects would cancel out and the net effect of trade liberalization on their real income is zero. However, if they also consume X and H, they will lose. The expected result is that the poor lose in the short run, but their loss is smaller than the decline in their wages, because of the gains from the effect of trade liberalization on the prices of things they consume.

iii) Poor produce only in the non-tradable sector. With the decline in the price of H, the wage rate in that sector also declines by about the same percentage. On the other hand, labor in H also benefits from the lower cost of consuming M and H. It is possible that the impact on the real income of the poor rises because the cost of the consumption bundle falls more than their wages. In general, the impact on the real income of labor in H is ambiguous and depends on the shares of M, X and H in the consumption basket, and on the response of the price of H to trade liberalization. The larger the share of M in the consumption basket of the poor, the greater the likelihood that they will gain. They must gain if they only consume M, they must lose if they only consume X, and they are unaffected if they only consume H.

These results are summarized in the matrix below(Table IV). Each cell in the matrix represents the "location" of the poor in terms of production and consumption. The first sign represents the effect of trade liberalization on the income of the poor, i.e. the return to their assets (labor). The second sign represents the effect on their real income due to changes in the cost of their consumption basket. Thus a "+" after the "I" sign means that the cost of their consumption basket has fallen following trade liberalization. The sign in parenthesis gives the net effect of changes in their nominal income and cost of their consumption baskets on their real-income in different "locations". To summarize, the best outcome is when the poor are employed primarily in the exportable sector X and consume importable goods M. And the worst outcome occurs if the poor are primarily employed in sector M and consume primarily exportable goods X.

Table IV : Location of the poor and effects of trade liberalization in the short-run

	M	X	H	TOTAL©
M	-/+(0)	-/-(-)	-/+(-)	-/(+)(-)
X	+/+(+)	+/-(0)	+/+(+)	+/+(+)
H	-/+(+)	-/-(-)	(-)/+(0)	-/+(?)
TOTAL®	?/+(+)	?/-(-)	?/+(?)	

Note:The Total© gives the effect for the poor that receive their income from production in only one sector but their consumption basket includes products from the three sectors.
Total® gives the effect for the poor that consumes products from only one sector but receive their income from the three sectors.

Although the discussion has focused on trade reform involving tariffs, in practice reforms often involve the abolition of quantitative restrictions (QRs) such as import licenses. As discussed above, due to rent-seeking, shifting from QRs to tariffs could significantly help the poor.

Effects in the Long Run

In the long run, labor and capital are mobile across sectors. Then, trade liberalization results in a contraction of sector M and an expansion of sector X. If, as is likely for most low income developing countries, M is on average capital intensive while X is relatively labor intensive, then, in the new output configuration results in an increased demand for labor and a higher nominal wage rate. As the prices of M and H fall, labor's real income rises as well. Consequently, while in the short run some labor employed in M loses from trade liberalization and the impact on labor in H is ambiguous, when factors are mobile, labor in both sectors gain. Of course, for this to apply to all the poor, labor markets need to be integrated. If they are segmented, then some poor could lose, especially if they are employed in the import competing sector and are unable to move. In order to ensure that the poor are better off following trade liberalization, the conditions affecting the functioning of the labor market are therefore critical.

In the analysis presented above, it is assumed that all factors are fully employed and changes in trade policy are reflected in changes in relative factor prices. In practice, and for many of the countries for which Poverty reduction strategies are being prepared, there may be a large supply of unskilled labor in the subsistence sector that can be employed at a fixed real wage in the modern sector. Trade reform may have a positive impact in this case, not through increase in the wages of the unskilled workers but rather by reducing the amount of unemployed or underemployed in the subsistence sector and inducing an expansion of the output of the modern sector. Indeed, following the Indian trade reform in 1991, manufacturing employment increased faster while wages increased slower than before the reform (Winters, 2000 a,b). In most cases, one can expect a lasting trade policy reform to have a mixture of quantity and price effects on the

labor markets. But no matter what the situation, labor mobility is essential in order to ensure movement of workers from the contracting and expanding sectors.

Sector-Specific Issues

The above framework is highly stylized and abstracts from many factors that are important in determining the impact of reform on the poor. Such factors include the existence of imperfect competition and inter-sectoral dependencies. For example, although the agricultural sector is generally made up of small farms, this is typically not the case for marketing and distribution services. In a number of LDCS, marketing is organized by public agencies, who usually fix producer prices at levels below world prices and do not always change them in response to changes in world prices or in exchange rates. An issue to take into account is the degree to which farmers consume their own output. The greater the share of own consumption, the smaller the impact of the reforms on the real income of the farmers. If farmers consume exactly what they produce, then the real income effect of trade reform on them is nil. If farmers are net buyers, it is often argued that in that case farmers lose from an increase in the price of the product they produce. This may well be the case, but one must also consider that in order to be net buyers, they need to obtain additional income. If this additional income is obtained by working on other farms, real income of these farmers need not decline given that nominal rural wages will tend to increase with the price of farm products (or increase with trade reform in the long run).

III.Trade Liberalization,Growth,Inequality and Poor

Trade is likely to make impact on the poor through higher growth. However, the impact on the poor over a period of years would depend on how steady the growth is and,also whether the growth is poor friendly.There are numerous individual country studies over the past three decades which suggest that "trade does seem to create,even sustain higher growth(Bhagwati and Srinivasan,1999).A country's trade policy is the key link in the transmission of price signals from world markets. In combination with the exchange rate, it allows resource allocation consistent with comparative advantage,thereby increasing productivity.An open trade regime and investment regime, encourages integration into the global trading environment and the import of diverse and modern technologies that are important for productivity improvements(See Coe,Helpman and Hoomaister(1997) for evidence and Romer(1994) for a further discussion.).Like, it has been argued that from 1960 to mid-1990s in some of the East Asian economies Hong Kong,Korea, Singapore, Taipei, Indonesia, Malaysia and Thailand it was domestic investment boom which sustained the growth process rather than outward oriented policies (Rodrik,1995) .According to him,exports were initially too small in relation to GDP to have a significant effect on aggregate growth.According to Rodrik the boom was the outcome of number of strategic government interventions and favorable initial conditions,such as the presence of an educated labor force and the equality of income and wealth.Many have contested their argument. Bhagwati (1996) opined that even if it originated from sources other than trade policy reform,the investment boom could not have nurtured in a closed economy.

However,for most of developing economies agricultural growth is important.The strategy of inward-oriented development,in which exports are not encouraged because imports are kept to a minimum,proved to be ineffective everywhere,even in most populous countries such as Brazil,China,India and the former Soviet Union(Bajpai and Sachs,1998).

Trade can affect the poor adversely if economic growth worsens the income distribution.Table V documents the data for India.This table reports worsening of distribution in 1997.

Table V:Distribution of Per-Capita Expenditure in India

Year	Lowest 20%	Second 20%	Third 20%	Fourth 20%	Highest 20%
1972	8.5	12.6	16.5	21.8	40.6

1973	**9**	**13.1**	**17.2**	**22.6**	**38.1**
1977	**8.5**	**12.5**	**16.4**	**21.7**	**40.9**
1983	**8.6**	**12.7**	**16.5**	**21.7**	**40.5**
1987	**8.9**	**12.5**	**16.3**	**21.3**	**41**
1992	**8.8**	**12.5**	**16.2**	**21.4**	**41.1**
1994	**9.2**	**13**	**16.8**	**21.7**	**39.3**
1997	**8.1**	**11.6**	**15**	**19.3**	**46**

Source:The figures for 1994 are from World Bank Development indicators on CDROM.All other figures are from NSS,reported in Datt(1999).

However,Deininger-Squire(1996) and the WIDER(2000) data suggests that there is virtually no change in income distribution(defined as share of bottom 40 percent) over twenty five year period,1972 to 1997.The constancy of the share of the bottom 40% has implication for studies on poverty.It means that the poor have shared equally in whatever economic growth has occurred.

Xavier Sala-I-Martin(2002) using data for 125 countries concludes that poverty rates as well as absolute headcounts-declined significantly from 1970 to 1998.Moreover,income inequality also declined,particularly in the last two decades .The author uses nine most common inequality indices in the economic literature to offer the same result:Though inequality remained more or less constant in 1970s,it declined substantially in the 1980s and 1990s.As a result,the shape of the income distribution has changed,from a bimodal distribution with peak of poor people and peak of rich in 1970 to a smoother distribution in 1998,suggesting emergence of world middle class.

Dollar and Kray(2001) defined the poor as the lowest 20 percent of the population,and assumed that poverty falls if the mean income of the bottom 20 percent goes up relative to the mean income of the population.Dollar and Kray's regression analysis,which used data from 80 countries for four decades,indicated that trade openness enhances growth,which affects all income groups proportionately,including the lowest quintile.This result was robust with respect to variation over time ,between rich and poor countries,and between crisis and non-crisis periods . However ,openness does not have any direct impact on income distribution-either positive or negative- other than through growth.
There are three reasons why growth is crucial to poverty reduction(Panagariya,2002).First,when the growth engine is nearly 3 percent or more in per-capita terms,it overwhelms any negative effects resulting from increased inequality.It gives rise to what Jagdish Bhagwati call the powerful pull -up effect rather than what skeptics call the trickle down effect. This effect rapidly brings the poor into gainful employment. Second, faster growth generates much more resources to finance anti-poverty programs. Finally, growth also improves the ability of the poor to access public services. At low levels of income, most poor people send their children to work. It is only increased incomes that result in the children being able to switch from work to school.

IV.Trade Openness, Growth, Inequality and Poverty: Empirical Evidence from Some Asian Economies

We have run OLS regression on cross country data for fourteen Asian countries[5].Statistical software statmost is used for the analysis.The countries included are India, Pakistan ,Bangladesh

[5] The cross-country regression approach has a number advantages for understanding the links between trade and poverty. First of all, it enables the use of traditional statistical tools for testing results and hypotheses, as opposed to only making predictions. Secondly, cross-country regression results are typically much more general than the country-specific results of many applied simulation models. Thirdly, cross-country regression may be able to account for some of the dynamic aspects of trade reform that are missed by static simulation models. Given the differing advantages and

,Nepal,Sri-Lanka from South Asia and Indonesia, Malaysia, Philippines, Hong-Kong, China, Japan, Singapore, Thailand and South Korea from East Asia.The dependent variable is poverty as measured by population below the international poverty line of $1 per day ;the independent factors are average annual trade openness and average annual per-capita GNP and GNP growth rates(1960-97) and measure of inequality -"Gini average"(the average Gini across all observations for the given sample period for each country included in the sample).Gini coefficient[6] in 1990s is also regressed on economic growth rates and trade openness to examine the impact of such factors on income distribution.

Regression analysis results shows that trade openness is one of the significant factors in explaining variation in growth of PCGDP for fourteen Asian countries(cf note in Table VI for the regression result).In turn economic growth process(1960-1997) has significant impact on reducing poverty for these economies in the 1990s(cf note of Table VII for the regression results).Trade openness has significant effect in reducing poverty for all countries in the sample. However, it becomes insignificant factor in explaining poverty when per-capita growth rates are included as an additional explanatory factor.The effect of trade openness is captured by per-capita growth rates.This suggests that trade openness has impact on poverty via raising economic growth rates(note Table VII).

Inequality of income(Average Gini) during the last three decades has no significant impact on poverty for the Asian economies in the 1990s.The t-values are insignificant but surprisingly they come out with negative signs for the sample included in our study suggesting that higher inequality tend to reduce poverty(note Table VII).

Also, neither economic growth nor average trade openness from 1960-1997 are significant factors in explaining inequality of incomes in 1990s as measured by Gini coefficient for the fourteen Asian economies. The signs of the independent factors suggest that higher economic growth rates tends to reduce inequality while higher trade openness tends to increase inequality(see note of TableVII).

The above analysis for the fourteen Asian countries confirms the results of other studies(Dollar and Kray,2001) that raising economic growth rates is the factor which reduces poverty across economies.Trade openness tends to increase economic growth rates.No significant relationship could be however found in our study between changes in inequality and poverty, and economic growth rates ,trade openness and inequality of incomes(see notes on Table VIII).

Table VI:Average Trade Openness,Growth of GNP,Per-CapitaGNP and Volume of Trade for Some Asian Countries

	Average Annual Growth Rate of Volume of Trade(1960-	Average Annual Growth Rate of GNP(1960-1997) Column(2)	Average Annual Growth Rate of Per-Capita GNP :1960-97	Average Trade Openess (Trade(Exports+ Imports)/GNP)in

disadvantages associated with the cross-country regression and simulation approaches, they should probably be viewed as complementary forms of analysis as opposed to substitutes.

[6] The Gini coefficient, although not a perfect tool, is relatively good summary indicator of income inequality .For discussion on the merits and drawbacks of using the Gini indicator see Deninger and Scquire(1996,pg.567).

	1997) Column (1)		Column(3)	% 1960-1997 Column(4)
Bangladesh	5.6	3.879	1.58	26.33
China	11	7.725	6.215	27.92
Hong-Kong	8.7	7.977	5.61	280.31
India	7.9	4.712	2.55	15.43
Indonesia	8	6.26700	4.24	50.94
Japan	5.100	5.5100	4.45	18.21
South Korea	12	7.94100	6.16	74.84
Malaysia	8.8	7.073	4.37	144.66
Nepal	6.9	3.465	1.12	34.83
Pakistan	6.7	5.743	2.78	34.82
Phillipines	8.3	4.179	1.45	55.41
Singapore	9.4	8.6	6.43	354.18
Sri-Lanka	4.1	4.572	2.88	70.40
Thailand	10	7.516	5.13	70.12

Source:GNP and Per Capita GNP data is in constant 1995 US $.GNP,PCGNP and Trade data from World Bank World Development Indicators in Cdrom for various years.
Note:Regressing Average Annual Growth Rate of GNP(Y-Column 2) on Average Trade Openness(X-Column 4) yields
Y=3.0545+ 0.5915X
t- (5.1640) (2.192)
R^2=0.28
F=4.809

Table VII: Economic Growth,Poverty and Inequality Index for Some Asian Countries

	Average Annual Growth Rate of GNP(1960-1997) Column (1)	Average Annual Growth Rate of Per-Capita GNP :1960-97 Column (2)	Average Population Below $ 1 a day in 1990s Column(3)	Gini Average Column(4)	Gini Coefficient in % in 1990s Column(5)
Bangladesh	3.879	1.58	29.1	36(1963-86)	33.6
China	7.725	6.215	18.5	32.68(1980-92)	40.3
HongKong	7.977	5.61	.1	41.58(1971-91)	42
India	4.712	2.55	44.2	32.55(1951-92)	37.8
Indonesia	6.26700	4.24	7.7	33.67(1964-90)	31.7
Japan	5.5100	4.45	0.1	34.82(1962-90)	24.9
South Korea	7.94100	6.16	1	34.52(1965-88)	31.6
Malaysia	7.073	4.37	0.1	50.76(1970-84)	49.2
Nepal	3.465	1.12	37.7	36(1960-90)	36.7
Pakistan	5.743	2.78	31	31.55(1969-88)	31.2
Phillipines	4.179	1.45	49	48.53(1957-85)	46.2
Singapore	8.6	6.43	.1	40.12(1973-89)	38
Sri-Lanka	4.572	2.88	6.6	42.50(1953-87)	34.4
Thailand	7.516	5.13	2	45.48(1962-92)	41.4

Source: GNP and Per Capita GNP data is in constant 1995 US $.GNP and PCGNP data is from World Bank World Development Indicators in Cdrom. for various years.Poverty

data(international poverty line) and Gini index(area between lorenz curve and line of equality) are from the World Bank World Development Indicators 2001.Note Higher values of Gini index indicate higher levels of inequality.Gini Average data in Column 4 for years indicated in the bracket(Sarel,1997)

Note:

Regressing Poverty (Column 3 of Table VII) on Trade Openness(Column 4 in Table VI)

Poverty= 24.21 -.088 Trade Openness

t-values (4.06) (2.00)

R^2=0.25

F=3.1

Regressing Poverty (Column 3 of Table VII) on Per-Capita Growth Rates(Column2 of Table VII) and Trade Openness(Column 4 in Table VI)

Poverty=46.037 -7.1471PCGNPGR-.019452Tradeopenness

t-values (5.862) (-3.347) (-.503)

R^2=0.1179

F=9.28

Regressing Poverty (Column 3 of Table VII) on Growth rates(Column I in Table VII) and Trade Openness(Column 4 in Table VI)

Poverty=61.285- 7.2272 GNPGR-.012184 Tradeopeness

t-values (4.048) (-2.588) (-.259)

R^2=0.533

F=6.285

Regressing Poverty (Column 3 of Table VII) on Per-Capita Growth Rates(Column2 in Table VII) and Gini Average(Column 4 in Table VII)

Poverty=70.1027 -7.755PCGNPGR -0.61 GINI Average

t-values (3.30) (-4.51) (-1.18)

R^2=0.662

F=10.8

Regressing Inequality of Income(Gini)-(Column 5 of Table VII) on Growth rate(Column I in Table VII) and Trade Openness(Column 4 in Table VI)

GINI= 36.04 - 1.78GNPGR +.023Tradeopeness

t-values (4.88) (-.1315) (1.0265)

R^2=0.06279 ,F=.7447

Regressing Inequality of Income(Gini)-(Column 5 of Table VII) on Per-Capita Growth Rate(Column2 in table VII) and Trade Openness(Column 4 in Table VI)

GINI=37.533 -.78803PCGNPGR +.0228 TRADEOPENNESS

t-values (-.691) (1.416)

R^2=0.154

F=1.005

V.Identifying Good Trade Policies Which Can benefit the Poor

In practice,the most practical way of stimulating trade and opening up to the international economy is through liberal trade regimes,rather than through a complex structure of protection and export incentives.The basic elements of a good trade policy regime involve predictability,transparency and uniformity.A liberal trade regime provides guidance for the direction of reforms.

As a practical matter,duty drawback mechanisms are ineffective in most of the developing economies,Thus,a regime with high protection will diminish exports and growth.Moreover,differentiated structures of protection and subsidization creates opportunities for elite's and powerful producers groups to capture trade policy for their special interests.This lobbying for protection and subsidies engenders corruption and inefficiencies which,in end hurt the poor.

These problems can be avoided by simple and transparent protection regimes of low uniform tariffs.Most low income countries have differentiated tariff structures with significant tariff escalation.The main reason include fiscal objectives,import substitution motivations combined with the political weight of vested interests.Tariff escalation is a problem since it affords high effective protection to final goods producers,thereby discouraging the development of intermediate industries.Exporting of intermediate products is an important way for developing countries to participate in modern global economy;but these activities are discouraged by the escalation of tariifs.

A uniform tariff conveys a number of advantages(Tarr,2001),the most important of which is that if the tariff is uniform,the gains to industry lobbying are much smaller(and may be negative),creating a kind of free rider problem for the lobbying industry and dramatically reduces the incentive to lobby for protection[7]

A uniform tariff greatly simplifies custom operations,eliminates a number of ways used to avoid paying the tariff and should help reduce corruption and save on scarce administrative resources.There will also be a direct saving of resources from reduced lobbying for higher protection and an associated gain from encouraging scarce entrepreneurial talent to be employed more productively in the creation of better and cheaper products.Overall,the level of protection is likely to be lower as the incentive to lobby for higher tariffs is attentuated.Many of these factors are pro-poor as they greatly reduce the scope for the exercise of power and rent seeking.

Uniformity does not imply that there can be no exemptions for products that are deemed to be of great social importance such as essential medicines. However, care should be taken that such exceptions target only products that are critical to attain social and public health objectives.

If tariffs are important for revenue generation,uniformity implies that the overall level of the tariff should be such as to generate the revenue required.However,some products such as alcohol and tobacco products may be subjected to high duties to raise revenue as long as equivalent excise taxes are imposed on domestic production.

Dispersion of tariffs often generated by exemptions and tariff escalation will lead to high effective rates of protection and is likely to entail significant inefficiencies.

Many countries tend to use anti-dumping as a safeguard instrument.India,for example is the largest perpetrator of anti-dumping duties(Mathur,2001a),This is not be advised.Anti-dumping is trade policy instrument that allows duties to be imposed on imports that are sold for less than

[7] Chile which has had a uniform tariff since 1979,is a dramatic case in point.In Chile in 1998,the legislature considered a progressive reduction of the uniform tariff from 11 to 6 percent,to be accompanied by one percent per year reductions through 2003.Chilean industry groups supported a reduction of the tariff,which passed the Chilean legislaturer.Evidently,uniform tariffs led industrialists to conclude that a reduction was in their collective interest.

what is charged in the exporters home market.That is,it can be invoked to offset price discrimination across markets.Such differential pricing usually reflects economic conditions and is not detrimental to welfare.As antidumping is an instrument that is easily captured by industries to raise the price of imports,and requires the use of scarce administrative resources,it is counterproductive to economic development and poverty reduction.If there is need to raise protection because imports injure domestic industry it is preferable to use WTO consistent safeguard actions as they allow the country to consider the impact of taking action on the economy as a whole,including the poor as opposed to simply the industry that confronts import competition.[8]

The best policy option from a development perspective in this area is to have no anti-dumping instrument.If anti-dumping procedures are adopted efforts should be made to establish procedures that allow for the national interest and the impact on the poor to be taken into account prior to the imposition of an anti-dumping duty.

In addition to the commercial policy instruments there are number of trade related institutions that can have important implications for the impact of trade reforms.

Custom clearance efficiency and transparency is an important determinant of the costs associated with trade.Burdensome and redundant procedures-red tape-can give rise to substantial uncertainty and are often associated with rent seeking and corruption.Minimizing discretion by simplifying as much as possible the clearance process,including through adoption of international standards for classification of goods,elimination of most exemptions and providing officials with training and appropriate information technology are important dimensions of trade reform.An efficient customs clearance process ,with little red tape, that ensures tariff free access to intermediate imports for exporters is required.

Non-tariff barriers include mechanisms such as quotas , licenses and monopoly rights to import.When these mechanism are in place for reasons other than for health or safety they are the most pernicious of trade barriers in terms of their harm to growth and poverty alleviation.Partly this is because non-tariff barriers encourage competing interest to lobby to obtain the valuable licenses to import.This competing lobbying activity(know as rent seeking) wastes valuable resources.Non-tariff barriers also lack tranparency,and and thereby may allow protection to go relatively unnoticed. As discussed above,the political economy of protection suggest that import controls(and then sometimes export controls) are usually put in place to benefit powerful interest groups,not to help the poor.

The overall analysis of the trade regime should yield a preliminary judgement on the desirability of trade reform.Analysis of both the impact of the status quo policy and the alternative reforms on the poor is important.The tools to undertake such an analysis can be constructed for most economies;the basic requirements include detailed data on imports and exports,the trade barriers that apply to those goods,household survey information on the consumption pattern of the poor and the sources of their income and data on the basic structure of the economy.

This judgement should be reviewed in the light of the potential short term effects of trade reform on the poor.If there are possible negative affects,it is important to identify the relevant products and sectors early on,in order to help design arrangements for dealing with adverse impacts of the reform and develop strategies for developing consensus in their support.

It might appear tempting to design a pro-poor trade reform by identifying sectors that are important to the poor-either on consumption side or the income side and signaling out these sectors for differentiated cuts in protection.There are atleast two problems with this approach.One is fundamental and the other relates to political economy.The fundamental problem is that trade policy is a single instrument and a fundamental principle of economic policy formulation is that a

[8] Under the WTO,safeguards also require compensation to be offered to exporting countries if the action lasts more than 3 years.This is useful mechanism to ensure that protection is temporary.See Hoekman and Kostecki(2001) for more detailed discussion.

single instrument cannot be expected to address multiple targets.The political economy problem is that once a highly differentiated trade regime is adopted,it is essentially impossible to stop special interests building a case that their sector deserves special treatment for one reason or the other.

A better approach is to focus on developing two different sets of instruments-one trade policy,focussed on providing the incentives appropriate for efficient production and use of goods and services and another distributional policy,focussed on alleviating poverty.A set of distributional instruments will necessarily have a much wider range of dimensions,including investments in expanding access to education,the provision of safety nets,and a range of infrastructure investments needed to allow people in poorer regions access to the markets and other amenities enjoyed by relatively disadvantaged people.

VI.Guidelines for Poverty Reduction in the light of Trade Liberalization[9]

As discussed above the effect of trade reform on poverty in the short run hinges on the impact on incomes.The effects in the long run will depend on the growth process which in turn will depend on variety of complementary policies and institutions.The key complementary policies are 1) macroeconomic & microeconomic stability[10] and especially adopting competitive exchange rate policy2)the operation of the market for labor(mobility),since the poor are often concentrated in the informal sector3)the operation of the markets in agriculture-which is both source of income and accounts for large portion of the household expenditures of the poor4) access of the poor to trade related services-for example credit, marketing ,transportation, communication & information and 5) access to safety nets 6)reducing corruption,enhancing political stability,peace & property rights for all ,implementing rule of law, i.e having quality governments.

Conclusions:

There is unambiguous empirical evidence from economies around the globe and for some of the Asian economies included in our sample that trade openness promotes economic growth. Raising economic growth in a sustained manner reduces poverty.However, most of the poor in the developing economies are in the agricultural sector,therefore raising growth in the agricultural sector is essential ingredient for making the reform process successful.Further,for cross section of fourteen Asian economies included in our study no significant relationship could be found between changes in inequality and poverty, and inequality of incomes with economic growth rates and trade openness .As there is no convincing evidence that economic growth per se could lower income and wealth inequalities.Policies like fully government funded public and social services with land reforms may be the key for promoting distribution of incomes in the countries.

The paper gives a framework of the various effects of a trade policy reform on the poor in the short and long run. A policy package of tariff reduction and currency depreciation should make it easier for the factors of production in importable sector in the short run and during the transition period,and should dampen the resistance to the reform.The impact of trade reform on the poor in the short run will critically depend on their location in terms of consumption and production

[9] Poverty is not only due to lack of income but also due to lack of capabilities (skill, education), livelihood, security and assets, ,troubled and unequal gender relations, exhausted and weak body, disregard and abuse by the more powerful, dis-empowering institutions, lack of radical and comprehensive land reforms,degraded environment, inadequate rural infrastructure, among others. Effective domestic policies for poverty reduction should cover all the above stated issues.Pre-occupation for long with minimal concept of poverty has impaired the capacity of anti-poverty strategies in eradicating poverty. The scope of this paper is however limited.

[10] Microeconomic stability refers to economies having competent governance, technological and managerial innovations, impartial judiciary ,efficient legal system and improvement in the quality of human resources.

(income), in particular whether they are employed in tradable or nontradable activities.The best outcome is when the poor are employed primarily in the exportable sector and consume importable goods . And the worst outcome occurs if the poor are primarily employed in importable sector and consume primarily exportable goods. The long run effects of trade reform are beneficial to the poor if the labor market functions efficiently.Labor market segmentation dampens the positive effect. The overall analysis of the trade regime should yield a preliminary judgement on the desirability of trade reform. The tools to undertake such an analysis can be constructed for most economies; the basic requirements include detailed data on imports and exports, the trade barriers that apply to those goods, household survey information on the consumption pattern of the poor and the sources of their income and data on the basic structure of the economy.

In the South Asian Region it is services that gained from the shift in the terms of trade against manufacturing, suggesting not only that skill differentials increased but also considerable part of the dividend from reduced tariffs was retained by trade and finance.

Simultaneously, despite overall GDP growth being maintained or slightly improved the growth of agricultural GDP decelerated throughout the region. This combination of slower output growth in agriculture with deteriorating terms of trade is the major reason why rural incomes in South Asia have tended to lag behind urban incomes. Globalization and trade reform would have had greater positive effect if agricultural growth would not have lagged due to falling terms of trade, low technology diffusion and cuts in public investment including investment in rural infrastructure,public irrigation,roads and power.As far as the effect of trade reform on employment in South Asian countries are concerned there is complicated picture as employment in the unorganized sector(which employs most of the labor force in the South Asian economies) is stagnant.

The basic elements of a good trade policy regime involve predictability,transparency and uniformity.A liberal trade regime provides guidance for the direction of future reforms.

Appropriate mix of trade policies with complementary macro and microeconomic policies is needed to benefit from interaction with the global economy. Macro-economic & microeconomic stability and a competitive exchange rate should be in place.

The safety nets are absolutely essential to alleviate and minimize pains of adjustment atleast in the short run.But if these pains are necessary to put the economy on a higher economic growth path,the society and polity will have to evolve credible mechanisms of cost sharing and conflict resolution.

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