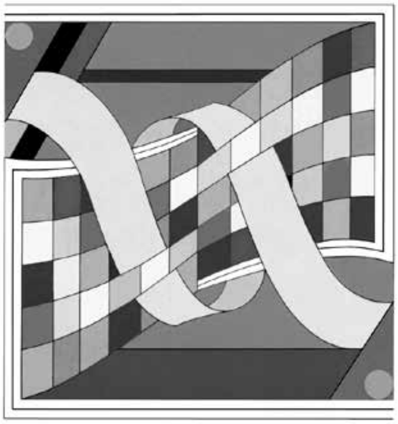


The Great Trade Liberalization Debate

By Matthew Rees

A review of

Free Trade and Prosperity: How Openness Helps Developing Countries Grow Richer and Combat Poverty
by **Arvind Panagariya,** Oxford University Press, 2019

The past four decades have marked the biggest and fastest rise in global living standards in human history, with more than one billion people escaping extreme poverty. Some of that progress is now threatened by the economic ripple effects from the coronavirus. The World Bank estimates that the pandemic could thrust up to sixty million people in developing countries into extreme poverty. As policymakers begin searching for solutions to the economic slowdown, it's inevitable that they will face calls to "protect" national markets by restricting imports and investment. And that is going to trigger a new chapter in one of the most contentious public policy issues for decades: Does trade liberalization contribute to higher growth, and lower poverty, in developing nations?

For anyone interested in this question, one book should be a "must read": *Free Trade and Prosperity: How Openness Helps Developing Countries Grow Richer and Combat Poverty*. It is an indispensable guide through the realities (and many of the myths) around trade, poverty, and economic growth. The author, Columbia University economist Arvind Panagariya, makes a compelling case that trade liberalization is a critical factor (though—importantly—not the only factor) contributing to long-term economic growth in developing nations. And in those nations, growth is the most powerful antidote to poverty. Ergo, liberal trade policies are fundamental to reducing poverty.

Panagariya begins his *tour de force* by noting the fundamental issue that has always faced free traders: "the benefits of protection concentrate in the sectors that get protected and are therefore easily identified. Costs of protection, on the other hand, are spread throughout the economy and therefore remain hidden."

He says that free traders have set too high a bar for themselves to climb over in support of their position. The real test, he believes, should be to demonstrate that open trade is more likely than protectionist policies to contribute to long-term growth. He presents reams of data in support of this view and deconstructs the studies that claim protectionism is the best path to achieve widespread prosperity. "Deep down, the opponents [of free trade] know that systematic evidence connecting high or increased protection to superior growth and poverty outcomes cannot be found, and that is the reason they have never looked for it. I know of no serious econometric study that even attempts to find such a link."

Free Trade and Prosperity is partly a helpful primer on how trade works. For example, one chapter is devoted to topics such as how trade contributes to specialization and exchange, promotes economies of scale, fosters competition, and enables technology diffusion—all of which make economies more efficient and contribute to economic growth.

Matthew Rees is the president of Geonomica and a former speechwriter in the Office of the U.S. Trade Representative.

THE INTERNATIONAL ECONOMY
THE MAGAZINE OF INTERNATIONAL ECONOMIC POLICY
220 I Street, N.E., Suite 200
Washington, D.C. 20002
Phone: 202-861-0791 • Fax: 202-861-0790
www.international-economy.com
editor@international-economy.com

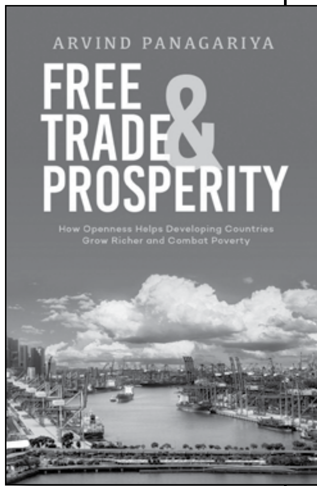
Has the strong growth in developing countries been caused by trade? Or just correlated with it? While trade critics charge that GDP growth is what drives trade growth, Panagariya delivers accessible retorts to this charge.

But as he also points out, poverty reduction in developing countries depends on much more than economic growth and economic openness. In the vernacular of economists, liberal trade policies are necessary but not sufficient. In a country with rickety and antiquated infrastructure (roads, ports, electricity), a low-quality education system, macroeconomic instability, little access to credit, misguided labor market regulation, and a corrupt system for distributing cash transfers to the poor, there will be severe constraints on the ability of trade to alleviate poverty.

Another element of *Free Trade and Prosperity* is a review of the recent historical record and the ways in which trade has contributed to economic development. Panagariya points to the experience of several developing countries that achieved high growth from 1961–1975, noting that nearly all of them expanded imports and exports during this period. By contrast, of the ten countries that experienced contraction or zero growth over this period, only one (Rwanda) achieved a high average growth rate of imports.

Similarly, from 1995–2013, fifty-eight developing countries achieved average annual economic growth of 3 percent or more (a growth rate achieved by only a small number of developed countries). Of these fifty-eight countries, all but fourteen had growth rates of exports that exceeded 5 percent. And the countries that have failed to benefit from the growing global economy of the past few decades are typically those that have failed to expand trade and foreign investment, proving the point Kofi Annan made while serving as Secretary-General of the United Nations: “The main losers in today’s very unequal world are not those who are too much exposed to globalization. They are those who have been left out.”

Has the strong growth in developing countries been caused by trade? Or just correlated with it? While trade critics charge that GDP growth is what drives trade growth, Panagariya delivers accessible retorts to this charge, closing with the results of a 1999 study by Jeffrey Frankel and David Romer, which focused on the part of total trade that is entirely linked to geography. They found that a 1 percentage point increase in the trade-to-GDP ratio increases per capita income by 2 percentage points.



Panagariya also provides comprehensive overviews of several economies that have achieved strong growth and significant poverty reduction in connection with trade liberalization. While some of them are small (Hong Kong, Singapore, and Taiwan), others are not.

He notes that during China’s period of high-octane growth, spanning 1982–2006, total trade as a share of GDP rose from just 15.1 percent to 70.6 percent. The growth in foreign direct investment was equally impressive. “Without this growth in trade and investment,” writes Panagariya, “economic growth and poverty alleviation could never have become what they did.” While acknowledging that several factors contributed to China’s growth rate, from privatization to infrastructure modernization, he says that, “none of these could have succeeded in bringing about the phenomenal transformation of China if the country’s leaders had chosen an inward-oriented trade and foreign investment regime.”

Panagariya is particularly strong on India’s economy. He makes the case that the decision by the country’s post-independence leaders to begin embracing protectionism in the late 1950s had disastrous effects, with the poverty rate staying almost constant until the mid-1970s and the country’s potential being severely hamstrung. But once the country began opening itself to trade and investment, poverty rates plummeted in both urban and rural areas.

***Free Trade and Prosperity* is partly a helpful primer on how trade works.**

Seventy years after a critical mass of developing countries started growing, writes Panagariya, there’s been no “unified, coherent, and full-scale defense of pro-free-trade policies with these countries at its center.” His goal with *Free Trade and Prosperity* was to fill that gap. He has more than met his goal. Indeed, his contributions will enrich not only the literature on trade and development but also the billions of people living in developing countries throughout the world—if policymakers heed his findings. ◆