THE INTERNATIONAL ECONOMY
THE MAGAZINE OF INTERNATIONAL ECONOMIC POLICY
888 16th Street, N.W., Suite 740
Washington, D.C. 20006
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# Reducing Poverty

BY WILLIAM R. CLINE

*A blueprint for successfully concluding the Doha Trade Round.*

Half of the world's population is in poverty today and live on $2 per day or less (at purchasing-parity taking account of lower local cost of living). One-fourth of the world's population has income of $1 per day or less. The proportion in poverty declined gradually in the last decade, but the absolute number remained approximately constant with growing populations.

The rich nations currently provide about $50 billion per year in official development assistance to poor countries. However, there is a second way the industrial countries could provide even greater benefits to the developing countries: trade liberalization. Removal of industrial country barriers would provide the opportunity to developing countries to boost economic growth through increased exports. Moreover, opening markets would give gains to the industrial countries themselves in the form of lower prices for consumers. These opportunities mean it is critical that the current Doha Development Round of trade negotiations in the WTO achieve deep liberalization that justifies the name. The Doha Round almost failed last September at Cancun, and it needs a new boost of political commitment from the leaders of both the rich G8 and the developing G-20 countries if it is to succeed.

The stakes are large. In a study just released, I have estimated that global free trade would confer long-term income gains of about $200 billion annually on developing countries. At least half of these gains would arise from removal of industrial country protection against developing country products, especially in agricultural goods and textiles and apparel. A truly forthcoming trade policy by rich countries could thus provide long-term gains to developing countries of about $100 billion annually, or about twice as much as present aid.

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The most direct impact of new trade opportunities on world poverty could come through imports from "at risk" low-income countries, including the Heavily Indebted Poor Countries (HIPCs), Least Developed Countries (LDCs), and sub-Saharan Africa (SSA). One-fourth of the world's poor are located in these countries. Based on the share of the poor in national income, the weighted average of industrial country imports from these counties has a "poverty intensity" of 45 percent, compared to only 7 percent for imports from developing countries on average. So one efficient way to use trade policy to reduce global poverty would be to grant immediate free market access for imports from these at-risk countries. Because the base of imports from these countries is small (about 6 percent of import from all developing countries, for the United States), any special adjustment problems in industrial country markets would be minimal, as would any likely trade diversion away from other developing countries.

Whereas the Generalized System of Preferences (GSP) has tended to have little effect because of product and country exclusions, more intensive special regimes have had more positive effects on developing country exports. These include the European Union's Lomé Convention and the United States' Caribbean Basin Initiative (CBI), Andean Trade Preference Act (APTA), and U.S. African Growth and Opportunity Act (AGOA) arrangements. So immediate, locked-in free entry for at-risk economies could deliver further growth and poverty reduction.

Three-fourths of the world's poor live in middle-income and other developing countries not in the at-risk groupings (including China, India, Brazil, and Mexico). Multilateral trade negotiations can reduce poverty in these countries too, by boosting exports and thus economic growth. Growth is the ultimate source of poverty reduction. On average, one percentage point of additional growth translates into a 2 percent reduction in the number of poor. This responsiveness of poverty to growth is higher in Asia, where incomes are distributed more evenly, but lower in Latin America, where incomes are more unequal.

Trade liberalization opportunities are large because industrial country protection against imports from developing countries remains substantial, and is especially high in agriculture and in textiles and apparel. Agricultural tariffs are high in Canada, the European Union, and especially Japan. Much of the public attention has rightly focused on agricultural subsidies. It turns out, however, that high agricultural tariffs in Canada, the European Union, and Japan are an even greater barrier than subsidies. Thus, for the European Union, agricultural tariffs against developing countries average 33 percent, whereas the tariff equivalent of subsidies stands at 10 percent.

Elimination of agricultural protection and subsidies in industrial countries would boost world agricultural prices, because domestic production would decline and import demand rise in these countries. The resulting impact on global poverty depends on whether the poor are mainly in the rural or urban sector and on the share of food in the household budget of the poor. Poor farmers would gain from higher incomes, but poor urban workers would lose from higher food prices. Because about three-fourths of the world's poor are located in the rural sector, global poverty would decline from the elimination of industrial country agricultural protection and subsidies. It turns out, moreover, that concerns about resulting losses for food-importing developing countries have been exaggerated. Most of the world's poor live in countries that are net agricultural exporters. Even most of the LDCs have comparative advantage in agricultural goods.

It is possible to obtain a summary measure of industrial country protection against developing countries, including both tariffs and subsidies and all product sectors. This Aggregate Measure of Protection turns out to be relatively low at 4 percent for the United States, significant at 10 percent for the EU, and relatively high at 16 percent for Japan. Although these levels are not high by historical standards, they remain substantial. Removing this protection could make a major difference for export opportunities for developing countries.

Using a leading model of world trade and protection, my study estimates how reduction or removal of protection would change trade, output, and earnings, calculated at the level of detail of 30 countries (or regions) and 24 product sectors. The impact on wages of unskilled labor is main basis for calculating the rise in income for poor households after liberalization. This increase is applied to each country's responsiveness of poverty to growth to compute the impact of multilateral liberalization on global poverty.

The results show, first, that agriculture is crucial to potential gains from free trade, accounting for about half of the total for both the industrial and developing countries. This confirms that agricultural liberalization is crucial if the Doha Round is to fulfill its potential. Second, between one-half and two-thirds of developing countries' gains from free trade arise from the removal of protection in industrial countries. This has been a controversial point, with some asserting that the great bulk of protection costs to developing countries are the result of their own protection, and that they thus shot themselves in the foot at

Cancun. Instead, their gambit at Cancun was a sensible strategy to force meaningful liberalization where it matters most: in industrial country agricultural markets.

Open trade contributes not only to greater efficiency but to more rapid productivity growth over time, by helping integrate world-class technology into domestic production and by prodding otherwise sluggish domestic monopolies. Past experience has shown that for each one percent increase in the ratio of trade to GDP, this dynamic productivity effect increases long-term output per capita by almost one-half percent. There is an additional contribution to dynamic gains from induced investment in response to cheaper imported capital equipment (once home protection is removed) and as new export opportunities arise. When all of the effects are taken into account, an estimated 540 million people globally would be lifted out of poverty over 10–15 years as a consequence of global free trade. This would reduce global poverty by about one-fifth from the level otherwise expected by 2015. Moreover, although this estimate is large, it does not include the impact of liberalizing trade in services.

A blueprint for successful conclusion of the Doha Round should include the following. First, the industrial countries would commit to deep reductions in, and eventual elimination of, tariffs in all sectors including, agriculture, textiles and apparel. Second, they would also commit to "decouple" agricultural subsidies from production and exports. America used to pay farmers to "set aside" acreage for conservation, reducing production; now it subsidizes production, placing a burden on the global market opportunities for developing countries. Moreover, today's farm subsidies go mainly to large owners, not traditional small family farms. The top 10 percent of farms receive two-thirds of the subsidies, which can range from $500,000 to $1 million per farm for the top recipients. Third, at least the middle-income developing countries would commit to major cuts in their own protection (e.g. by at least 50–60 percent). These liberalization commitments would all be phased in over several years, and with a longer time frame for developing countries. Fourth, the "second track" of trade policy would also be mobilized by the granting of immediate free access to imports from the at-risk countries (LDCs, HIPCs and SSA). Fifth, also in this track, the industrial countries would adopt tax incentives for direct investment in these countries.

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The second track could also help address the concern of LDCs that they stand to lose more from erosion of their existing trade preferences than they stand to gain from further multilateral liberalization. My model calculations show instead these countries would gain more from liberalization of their own markets and of markets in countries not currently granting free access (including middle-income countries) than they would lose from erosion of their preference margins from existing special access in the U.S. and EU markets.

Some might argue that the world's trading regime already faces enough distractions from environmental, labor, and other concerns that it should not be further burdened by attempts to link it to poverty reduction. The same argument might be made about fiscal policy—that it should focus on balanced budgets and ignore any attempt to moderate extremes in income distribution resulting from market forces. Even acknowledging that marginal tax rates went too high in the early postwar period before the pendulum swung back the other way, distributional laissez faire in fiscal policy would be a mistake. So would complete inattention to the opportunities offered by the trading regime to accelerate the reduction of global poverty.

There is no conflict between anti-poverty and trade efficiency goals in attacking the main locus of protection: in agriculture, textiles and apparel, and other labor-intensive goods. The main possible conflict arises in the second track of immediate free entry for at-risk economies. Some might fear that this head-start for these countries might undermine efforts to reduce most-favored-nation (MFN) protection. That fear would be largely ungrounded because the trade base for these countries is tiny compared with global trade aggregates. To ensure against adverse spillover to MFN liberalization, however, the best approach is a simultaneous package incorporating deep liberalization in the first track along with special free entry in the second. In that way, the timetable for dismantling global protection would already be locked in and not subject to possible subsequent lobbying by the head-start beneficiaries against erosion of their preferences through future multilateral liberalization.

Global free trade can make a major contribution to reducing global poverty. It is up to the policymakers in both the industrial and developing countries to ensure that the Doha Development Round seizes this opportunity. ◆