ODI OVERSEAS DEVELOPMENT INSTITUTE

OPINIONS

February 2004

www.odi.org.uk/opinions 11

Trade, investment and poverty

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Trade and investment matter for poverty reduction

Trade and investment are too important to be left out of national development strategies as they exert powerful effects, direct and indirect on poor people and poor countries. Even if the overall effect is positive, some groups may be adversely affected, and analysis must take into account the interaction between economic flows and policy responses. The poor and the non-poor themselves may adapt their behaviour to any incentive or shock from trade – but as our work in Africa shows, there are real differences in opportunities to participate in the new world economy.

Africa has experienced both the earlier non-economic globalisations (religious, cultural) and the last two centuries' economic globalisation, with high trade dependence and strong trade, capital, and political links to both north and east. The links are less dense than for other regions because of the nature of its trade, and it is less likely to see structural change from trade because its exports are still largely in commodities. To be less globalised than the average puts it at a disadvantage in a world where international regulation and international institutions are adapting to more globalised countries.

A study of the potential impacts of tariff reductions under the WTO, in textiles and clothing, pharmaceuticals and non-ferrous metals, reinforced the point that, while trade liberalisation offers potential benefits to developing countries as a whole, some countries (and some groups within every country) will suffer adjustment costs. The research identified, for each sector, the types of measures required to mitigate costs and to enhance potential benefits. ODI research on trade and poverty and on the income distribution impact of investment has been designed to help national governments coordinate domestic poverty reduction strategies with trade and investment policies.

Trade policy is absent in PRSPs

Given the importance of trade policy, it is surprising that it has not been given prominence in the new development framework of donors and national governments - Poverty Reduction Strategy Papers (PRSPs). Where trade policy is reflected in PRSPs , the policy line tends to mirror the simplistic language of wholesale and rapid liberalisation. Donors and governments have failed to encourage a national debate on trade and investment policy choices and trade-offs. Only one PRSP (for Vietnam) makes reference to a Poverty and Social Impact Analysis conducted on trade policy.

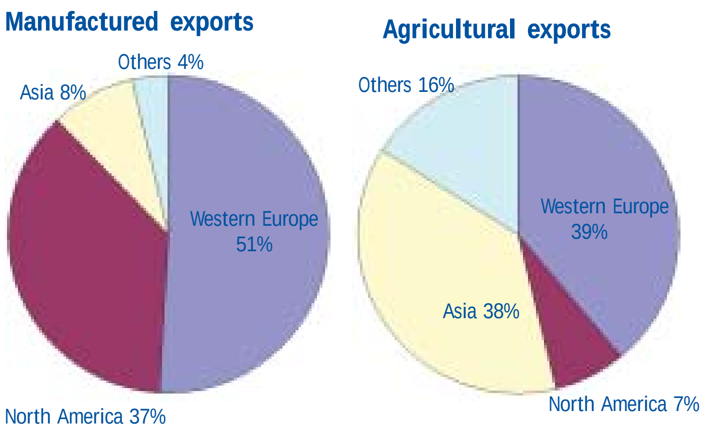
Most PRSPs tend to focus more on expenditure rather than economic growth. The trade content that does exist is rarely underpinned by poverty analysis. While some trade policy choices have been considered within existing PRSPs , few developing countries go beyond a simple discussion of standard export promotion measures.

Trade can be good for (some of) the poor

There is evidence that openness to trade and investment contributes to growth, as well as increasing efficiency and income, given conducive economic conditions and government policies. But growth itself does not guarantee poverty reduction. The impact on poverty depends on how the gains from trade liberalisation and investment are distributed among sectors, workers, households and government. Where poverty is highly concentrated in rural

Since the early 1990s, Uganda has grown rapidly, with a significant reduction in measured income poverty. Trade, notably coffee exports, made a major contribution to growth and poverty reduction in 1992–97. In recent years, trade growth has been dominated by non-traditional exports (especially fish). Trade has expanded employment opportunities and contributed to increased incomes. The main benefits have accrued to households employed in agriculture in the Central and Western regions, and to urban households employed in trade and services. A significant proportion of the population, the chronic poor, have not benefited and some have become worse off. The remote and insecure Northern region has not benefited.

Exports of least-developed countries by destination (2000)



areas , broad-based agricultural growth will have strong effects on poverty. The cases of coffee and fish in Uganda illustrate this point.areas , broad-based agricultural growth will have strong effects on poverty. The cases of coffee and fish in Uganda illustrate this point.By opening up new production possibilities, trade contributes to the shift from traditional activities to modern (often from agriculture to manufacturing or services).

So can investment

Investment affects wages and employment through the types of labour which foreign firms demand. There is evidence that foreign-owned firms in developing countries tend to pay higher wages but skilled workers tend to benefit more than less-skilled workers. With the exception of investment in textiles, most investment in manufacturing is likely to employ labour that is relatively skilled (in terms of the local market), and would not directly benefit the poor, although the poor may move into existing jobs.

Research on Latin American countries found that foreign direct investment tends to increase wage inequality there. FDI raised real wages of skilled workers more than wages of less skilled workers in Chile, while it lowered real wages of skilled workers less than wages of less- skilled workers in Bolivia. Appropriate policies to improve the distributional impact of FDI include good quality and appropriate education and training and linkage promotion between multinationals and domestic firms.

Trade in services

'Trade policy' and trade now go well beyond simple trade in goods. In particular, services trade is increasing rapidly. A higher share of services than goods has always been regulated nationally, while the reduction in barriers to goods trade has brought more previously regulated goods into trade. National regulation is increasingly either impinging upon trade or being required to change to accommodate trade. New conflicts have appeared between freer trade and national rules.

Developing countries need to participate more effectively in the WTO

Developing countries are increasingly taking part in international negotiations. From successfully modifying the outcomes of negotiations in the early 1990s, and then blocking an unwanted settlement (Seattle, 1999), many are now promoting their own initiatives (Doha Round). To succeed they need to develop domestic capacity to identify and coordinate objectives. But for them to be fully effective, the way in which the WTO makes decisions also needs to be changed: informal procedures are inadequate now that both its membership and its responsibilities have expanded.

Both developed and developing may need new policies

There are at least two ways to deal with the possible negative impacts of trade liberalisation on the poor. The first, the approach assumed in analysis of trade that finds that it increases welfare, is to compensate those who are hurt by trade liberalisation with effective safety nets. The second is to plan trade liberalisation to favour sectors with a direct impact on poverty, in the context of a comprehensive development agenda encompassing structural and institutional change and improved delivery of social services.

For investment, policies can increase the potential for workers and the economy to benefit from investment. For workers, these include education, training and industrial relations. Encouraging efficiency of domestic firms will enable them to benefit from linkages with foreign firms. Attracting investment into areas or sectors that are most likely to benefit the poor will improve direct effects.

Finally, trade and investment policies should be developed in a transparent and accountable manner, by national governments, with the support of donors. National governments should be responsible for opening up debates on the trade-offs associated with different policies for different groups of people. Northern governments could contribute by removing the constraints to improved trade and investment. This will include aid investments to strengthen transport infrastructure, health, education, and regulation and also to meet adjustment costs. But it will also include removing market access restrictions harmful to producers in developing countries.

This is an edited version of a Policy Brief published in ODI Annual Report 2002/2003

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