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My remarks will be based upon a book that I published in 1997 and a book that I'm working on now. The '97 book was on the role of trade in U.S. wage inequality and the second is on trade policy and global poverty.

In the United States, wage inequality did rise for a couple of decades. The ratio of wages for those with at least some college education to those with high school education or less rose by 18 percent from 1973 to 1993 (Figure 1). Now this, arguably, might not be a problem if this were solely from a boost of the upper end wages while the lower end wages were rising, only more slowly. Unfortunately, during this period there was an absolute decline in wages of, for example, high school dropouts (Figure 2). It was only the upgrading of the labor force and increased incidence of two wage earner families that prevented a substantial reduction of median household income in this period.

The late 1990s, the boom economy, made things better. But I think the question has continued "What is the role of trade in how wage inequality has evolved?" Now, economists favor trade but they acknowledge that there's core theory, technically it's by *Heckscher and Ohlin*, that open trade for the United States could in fact boost skilled wages relative to unskilled wages because the U.S.'s abundant factor is skilled workers. So that when we get more export opportunities those workers work in the sectors where we have our natural comparative advantage. It tends to give them more demand for their goods and the folks who were protected tend to have less demand for their services. Economists have to acknowledge that there is some theory that recognizes there can be an unequalizing effect.

The framework for this is the diagram that anyone who has taken economics 101 has seen (Figure 3). It is a demand and supply diagram. You have the quantity of skilled relative to the quantity of unskilled workers on the horizontal axis and you have the wage of skilled workers relative to the wage of unskilled workers on the vertical axis. The relative wage is a relative price that responds to relative demand and supply. What we've done in this country is to move the supply of skilled relative to unskilled from A to B. Basically, we went from college and above being only 60 percent of below college to being 120 percent in this period. So we should have experienced a sharp reduction, walking down the demand curve for skilled wages relative to unskilled wages. Instead, we observed exactly the opposite. That can only be explained by an outward shift of the demand curve for skilled relative to unskilled workers. Instead of the wage falling to Z2, it rose to Z3. Now, economists have been divided on the role of trade in all of this. The dominant view tends to be that skill-biased technical change, particularly with the advent of computer technology, shifted this demand curve out in that way and boosted relative skilled wages despite the increase in college graduates.

In a model that I developed in my '97 book where I tried to quantify the role of trade in wage inequality trend, I actually have international production modeled and I do simulations of what would have happened if we hadn't had a decline in transport costs, we hadn't had a decline in protection, if we hadn't had an increase in immigrants of unskilled workers into this country, and these sorts of things. The results that I got were quite striking to me when I first realized that the main thing to happen was this increase in college education, so we should have seen a negative 40 percent change in the ratio of skilled to unskilled workers' wages (Figure 4). So, in a sense, it must have taken a tremendous amount of unequalizing forces to more than offset this big equalizing force. Among the unequalizing forces, I calculate something like a 6 or 7 percent boost in this wage ratio from trade, a 2 percent boost from immigration, a 5 percent boost from the erosion of the real minimum wage, a 3 percent boost from the process of deunionization where there has been a sharp reduction in the union incidence, and a residual

for technological change. The last two, these big columns in the chart, are sort of what is left over. Economists really don't know how to divide them. Instead of attributing all of the unknown to technical change, I somewhat whimsically say, well what if only half of what we don't know is technical change and the other half is what we really don't know. But anyway this is the way that I parsed out the roles, so you can see that that means that trade itself only caused about 1/10 of the unequalizing pressures that were going on from all of these changes and it is highly likely that technical change was the principal driver.

What are the policy needs? Certainly not protection. Protection causes inefficiency. That would do little to raise unskilled wages while it would reduce the potential for skilled wages. The cost of apparel protection, for example, tends to be disproportionately borne by low-income households.

What these findings do imply, though, is that it is terribly important to make sure that the gains from trade are fairly distributed, and that there is a whole array of other equity oriented policies that make it possible to make sure that the efficiency gains from trade are fairly shared.

Now in that regard, I was favorably surprised with the trade adjustment assistance component of the trade promotion authority that was just passed in August. It seems to me that this was an instance in which the process was explicitly recognizing you had to make sure that everyone was brought along, that when there are new trade opportunities and new income opportunities for those that have the skills to take advantage of it, there are also mechanisms to share the gains with those who experience adverse transitional impacts. The new trade adjustment law provides for coverage of secondary workers, in other words, those in sectors supplying the trade affected workers as well as the directly affected. It provides a health insurance subsidy, which we heard about earlier this morning. Partial wage insurance for some compensation for those whose wages in the new job are lower. Extended coverage. All in all, an important step in the direction of making sure the gains are shared, though undoubtedly not the end or a fully sufficient step.

Let me turn then to the second question, how trade affects global poverty. The demonstrators in Seattle and in Prague believe that globalization causes poverty in developing countries. Most economists, I think, would argue that trade helps reduce global poverty. That trade, in particular, contributes to growth and that growth is the only sure engine over time to reduce poverty. Moreover, again going back to the classic economic theory, the developing countries have a comparative advantage in unskilled, labor-intensive products. Trade is precisely the opportunity for them to boost the wages of unskilled workers.

Let me share some thoughts from my current work on the trade policy and global poverty issue. First, if you haven't worked with the numbers, they are kind of staggering. If you use \$2 a day, adjusted for purchasing power, half of the global population is poor. Needless to say, a lot of these are in India, China, Indonesia, and Pakistan (Figure 5). There is a lot of poverty. It is not a small problem.

Now let me read what Figure 6 is supposed to say, relating poverty incidence and per capita income (percent in dollars per PPP). On the vertical axis you can see that poverty is as much as 50 to 90 percent of the population in countries of less than \$1,000 per capita income (horizontal axis). As you increase per capita income, you are going to reduce the incidence of poverty. Now that then asks one to consider what is the relationship of trade to growth. Basically, Figure 7 shows that increased exports tend to be associated with more growth. Growth in turn influences poverty quite sensitively. For every 1 percent increase in per capita income, you get a 2 percent reduction in the incidence of poverty, in general.

Now, does this correlation really mean that trade helps growth? Well, there is some controversy here and particularly on the question of whether you can get there by completely opening your borders to duty-free imports. I think, however, that it is fairly irrefutable that better export opportunities translate to better growth and hence to reduced poverty.

So, what can the industrialized countries do to help reduce global poverty? It seems to me that one of the fairly obvious thing they can do is to increase the access to their markets so

that developing countries can increase exports and reduce poverty. I'd say that there is a special opportunity if you focus your attention on countries that are really poor – the at-risk countries. The Least Developed Countries (LDCs), the Highly Indebted Poor Countries (HIPCs), and countries in sub-Saharan Africa have 700 million people who are poor by the \$2 standard (Figure 8). That's a fourth of the global total. So, there is a lot of return, if you are going to officially address global poverty, to thinking very carefully about these countries. Moreover, these countries account for only 7 percent of U.S. imports from the developing countries at large (Figure 9). So, that means that there is an opportunity to do something special for these countries. First, there is very little risk of a massive flood of imports from them because there is such a small base of imports. Secondly, those who worry about trade diversion from other developing countries don't need to worry much because, again, it is a very small share of the total of imports from developing countries.

Another aspect of an efficient way to look at how you would go about addressing global poverty is look at, what I've called, the poverty intensity of trade. You ask where are the imports coming from? Are they coming from Switzerland or are they coming from Bangladesh? That is what I'm sort of getting at when I look at the poverty intensity of trade.

Now, on average for our imports weighted by our trading partners from developing countries, about 38 percent of our imports represent imports from the poor by head count, but only 8 percent by income share, because even though we might import a lot from China, for example, the share of the poor in total income in China is relatively low (Figure 10). Now if you look in contrast at this set of three at-risk groupings: least developed, HIPC, sub-Saharan Africa – poverty intensity is 60 to 70 percent on a head count basis and it is 40 to 60 percent even on a share in income basis. It appears to me that these are fairly efficient target areas to think about. That suggests a policy that presses for special access for the at-risk countries.

Now, the African Growth and Opportunity Act (AGOA) for sub-Saharan Africa is an important step in this direction. It has a fairly long time span which is an improvement over

generalized preferences, and no competitive need limits. It is more generous on textiles and apparel. At the same time, it is for a small trade base, only \$20 billion and two-thirds of that is oil. It is not exempt from antidumping safeguards and it has fairly strict rules of origin for textiles and apparel. But it is a step in the right direction. Here are other steps to take:

1. If you really wanted to go after global poverty, why not focus on these three at-risk areas and expand the AGOA model. Add HIPC, and add the least-developed countries in sub-Saharan Africa,
2. Sharply simplify the rules of origin.
3. Give it a ten-year assured status.
4. Get synergy by making direct investments in these countries tax free. From our standpoint, treat taxation such that if the country itself decides to give a tax holiday, that's not offset by our taxes. That's technically shifting from a residency to a territorial base in the tax treatment so that if an African country wants to give a tax holiday we shouldn't negate it by imposing our corporate taxes on a residency basis.

Now more generally, let's turn to the whole range of developing countries. The Doha Round does provide an opportunity for reducing protection and for increasing their growth opportunities. We know that the manufacturing tariffs, after several rounds, are fairly low. If you take manufactures on average, tariffs are only about 3 percent against developing countries. They are about 1½ percent against industrial countries.

But there are two areas where protection is high. One is textiles and apparel and the other is agriculture. Quotas and tariffs in textiles and apparel mean that the total tariff equivalent is quite high in this sector, about 25 percent for the United States, 15-20 percent for the EU (Figure 11). Here the key is to not derail the promised liberalization already on track with the elimination of the multi-fiber arrangement (MFA) by 2005. This was set up like a truck headed off the cliff because liberalization has been back-end loaded and that means that this is

a little bit like the complete elimination of the inheritance tax and one year later its complete reinstatement. The challenge will be that we don't get a lot of new types of protection through contingent protection that essentially replace the MFA in 2005.

The tariff equivalent in agriculture ranges very high. The WTO system has ended quotas but now has tariff rate quotas which apply extremely high tariffs if imports are over the quota threshold. The effect of this is a total tariff equivalent of 35 percent in the United States, 100 percent in the EU, 230 percent in Japan (Figure 12). These levels are oppressive. Again, developing countries have a natural comparative advantage in agriculture because that can be a labor intensive good. A lot of them have a lot of land. It is also land intensive.

There is one tricky aspect of agriculture which I haven't heard too much about and I do think it warrants some thought. Food, after all, is the primary consumption good of the very poor. The effect of liberalization would be to boost global food prices. So it raises a bit of tension, certainly for the urban wage earners in low-income countries. Agricultural liberalization could potentially have a negative effect by boosting their food prices. How one fully works through this tension is not fully clear, but I don't think that it is too helpful to totally ignore it. In my more speculative moments, I think that the WTO, in addition to having a permissible green box or blue box for certain agricultural subsidies, should also have some sort of "alms box" that permits an agricultural subsidy as long as there is a donation of an equivalent amount to a stockpile for global famine relief or some other initiative for the food access aspect of global poverty. The notion is somehow to look at the other side of the gains from agricultural liberalization to see what happens to the living costs of the very poor who are not being directly being compensated by increased earnings as farmers. Obviously, a lot of poor aren't farmers.

Overall protection, and these are calculations I put together, comes up to an aggregate measure of protection against developing countries that is about a 9 percent tariff equivalent in the United States, 19 percent in the European Union, and 45 percent in Japan because of agriculture (Figure 13). These are the kinds of numbers that, in contrast to the 3 percent

industrial tariffs, say that there is quite a bit of unfinished business to take care of in the Doha Round.

The potential, then, is there for trade policies in the industrial countries to make a contribution to reducing poverty in developing countries. World Bank estimates are that, without change in trade policies, there could be a reduction in poverty from 2.7 billion to 2.2 billion by 2015. But if we do trade liberalization globally, that could be cut down to about 1.85 billion (Figure 14). So an extra 300 or 350 million people could be lifted out of poverty if there were aggressive trade liberalization. Similarly, the World Bank has calculated global static benefits of something like \$250 billion dollars annually. Something like \$50 billion of that would accrue to developing countries as a consequence of liberalization of protection in the industrial countries. That's about 0.8 percent of GDP (total of developing and transition countries in 2001 in market dollars) and that's before adding dynamic effects.

That means that trade opportunities are an important instrument for reducing global poverty. It also means that trade is no panacea. The basics of good economic policy, especially good governance remain first and foremost as the determinants of the growth, and growth is the main determinant of the reduction of poverty. More open trade and increased export opportunities for developing countries is something concrete that the industrial countries can do. It is also something that is good for the industrial countries' consumers as well, as long as we remember that measures such as trade adjustment assistance will be necessary if we are honestly going to say that we are sharing fairly the benefits of globalization.

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Figure 1

US wage ratio: 13+ years /12- years
education (%)

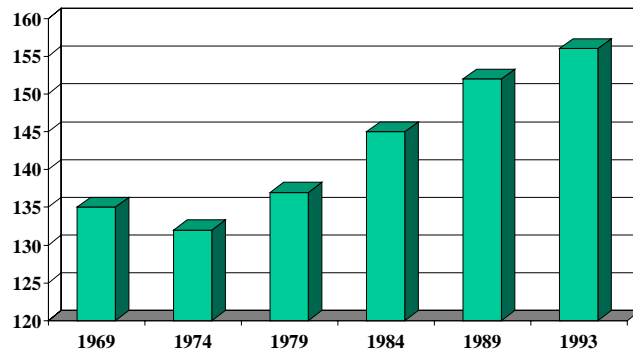


Figure 2

Real hourly wage (1973 = 100)

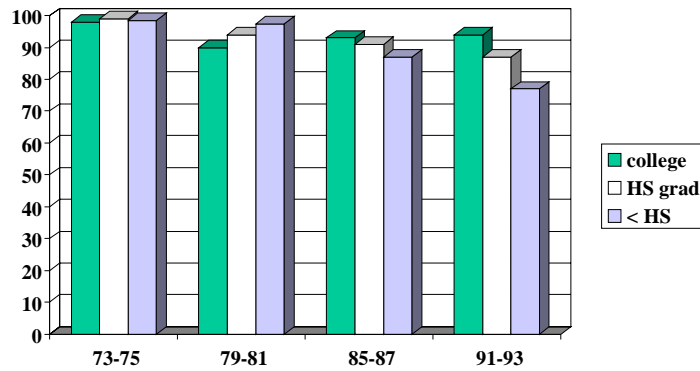


Figure 3

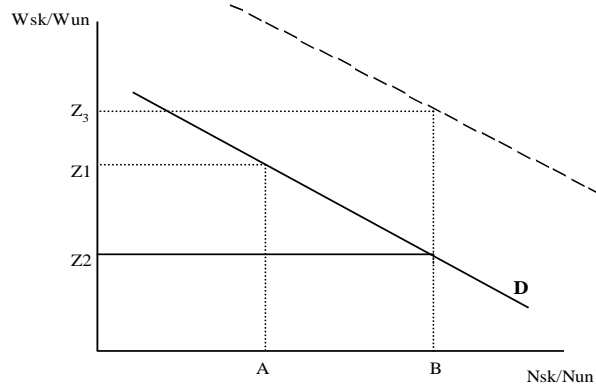


Figure 4

Impacts on skilled/unskilled wage ratio (%)

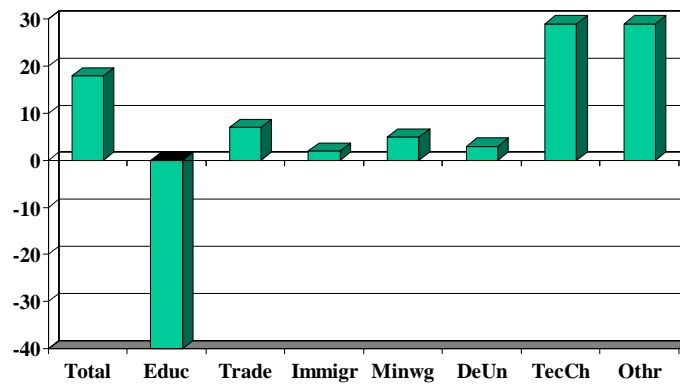


Figure 5

Global Poor (2.9 billion)

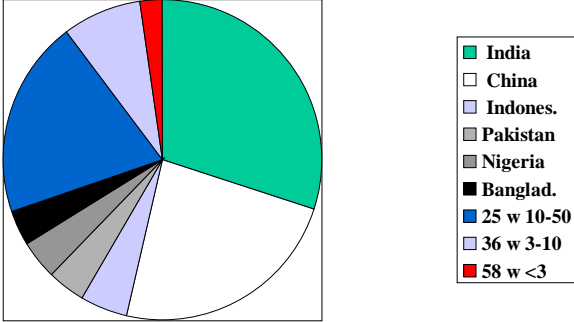


Figure 6

Poverty incidence and per capita income (% and ppp \$)

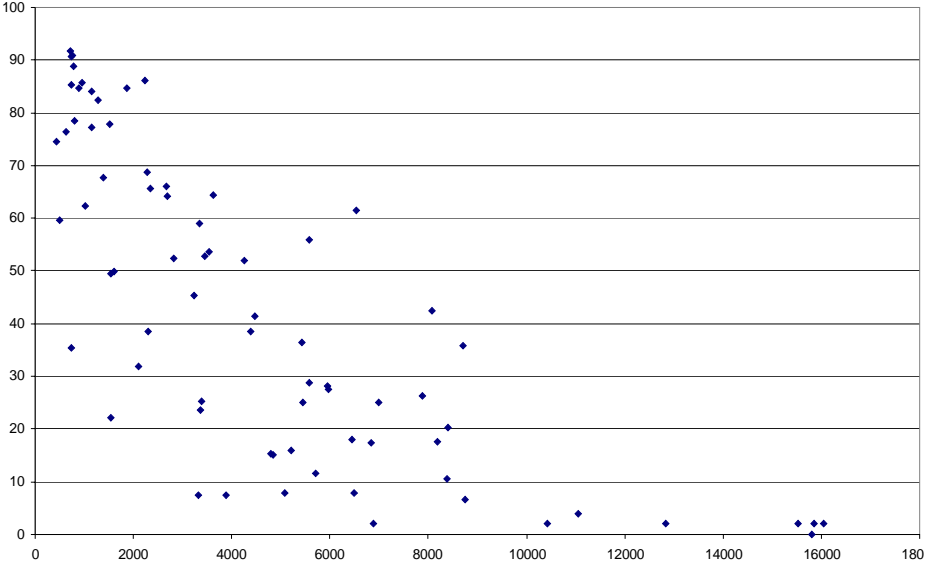


Figure 7

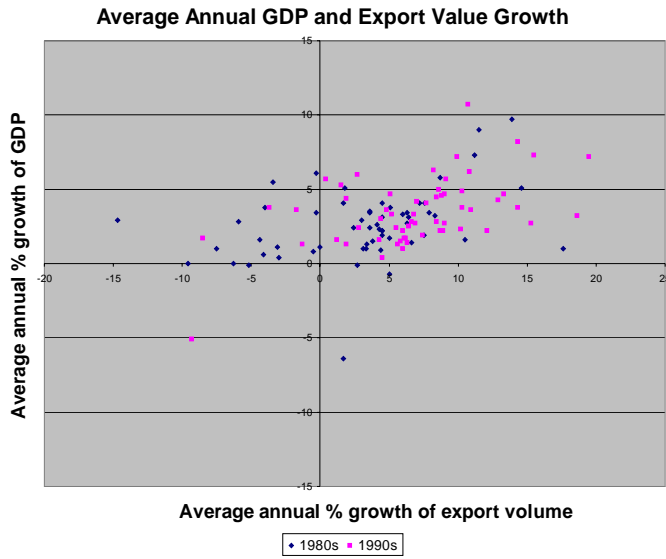


Figure 8

Poverty in Special-Regime Countries (millions)

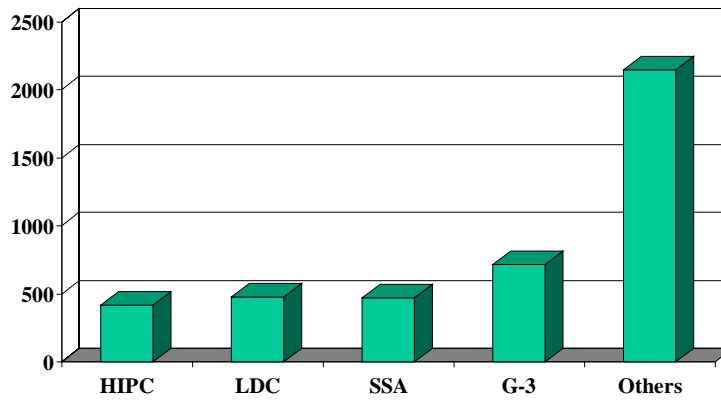


Figure 9

US Imports from developing countries, 2000 (\$ billion)

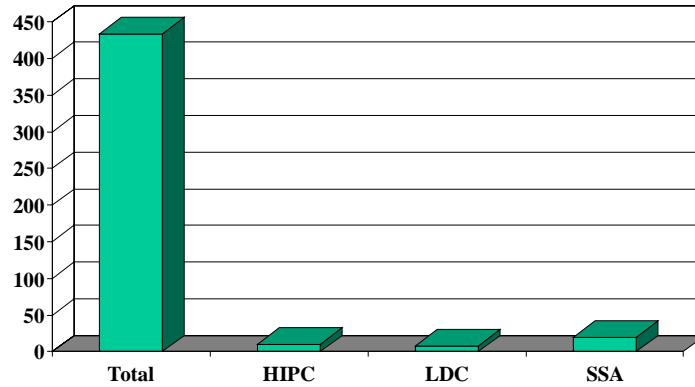


Figure 10

Poverty Intensity of US Imports from Developing Countries (%)

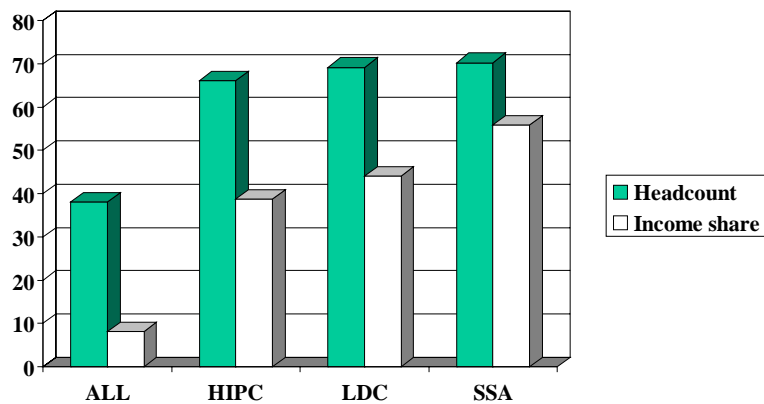


Figure 11

Tariff-equivalent in textiles & apparel (%)

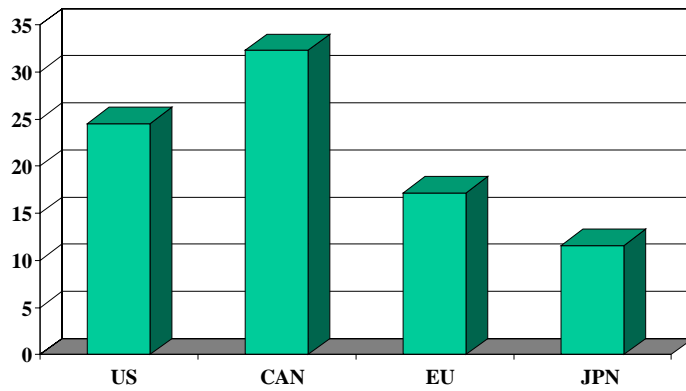


Figure 12

Agricultural tariff-equivalent (%)

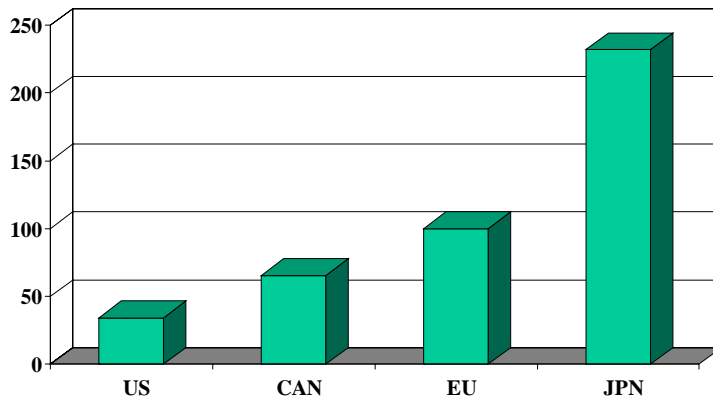


Figure 13

Aggregate Protection against Developing Countries (%)

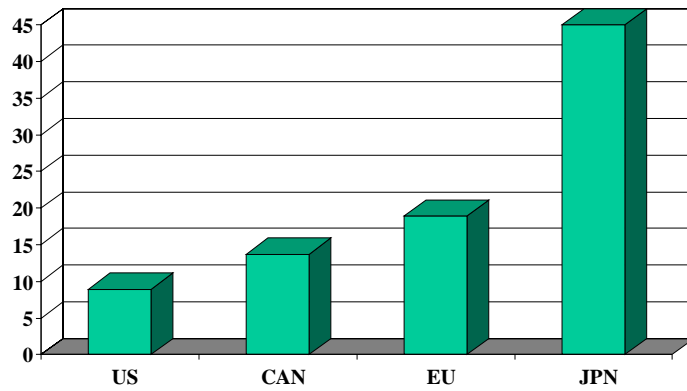


Figure 14

Impact of free trade on global poverty (World Bank)

