# Trade, Globalization and Poverty

*Edited by*
**Elias Dinopoulos, Pravin Krishna, Arvind Panagariya, and Kar-yiu Wong**

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# Introduction

*Elias Dinopoulos, Pravin Krishna, Arvind Panagariya, and Kar-yiu Wong*

This volume celebrates the seventieth birthday of Jagdish Bhagwati, the pre-eminent scholar, teacher, and public policy intellectual in the area of international trade in the world today. Jagdish was born on July 26, 1934 and did his schooling in Bombay. He went off to do his first degree at St Johns College at Cambridge, England during 1954–1956, where he first met his teacher, the great international economist Harry Johnson. It was during his second year at Cambridge that Jagdish wrote his famous article on immiserizing growth (Bhagwati, 1958). He graduated with a first in the Economics Tripos.

Jagdish spent the year 1956–1957 at MIT, where he met his future wife, Padma Desai. He then returned to England for postgraduate studies and spent the years 1957–1959 at Nuffield College, Oxford University. He moved back to India in 1961, joining first the faculty at the Indian Statistical Institute (ISI) and then, in 1963, that at the Delhi School of Economics. It was during these years that Jagdish wrote (jointly with V. K. Ramaswami) his path-breaking article (Bhagwati and Ramaswami, 1963) on the theory of distortions that laid to rest many arguments for protection. In a nutshell, the authors demonstrated that once a distortion was corrected at source, free trade still remained unambiguously beneficial.

In 1966–1967, Jagdish visited Columbia University and went on to join the faculty at MIT in 1968, where he later became the Ford International Professor of Economics. During his MIT years, Jagdish turned the work that he began at the ISI into a full-blown *Generalized Theory of Distortions* (Bhagwati, 1971), with virtually all scholars of international trade at the time deriving inspiration from it. In 1980, he commenced his work modeling political economy aspects of international trade policy (Bhagwati, 1982) and moved to Columbia University, where he is currently a Professor and continues to write prolifically on all aspects of globalization. His book *In Defense of Globalization* (Oxford University Press, 2004) offers a definite rebuttal of virtually all the important arguments made by globalization skeptics.

The accomplishments of Jagdish Bhagwati are too numerous to count here. We only note that he has deeply influenced the world of trade theory as well as the practice of trade policy and is widely recognized today as the world's foremost defender of free trade. For his scientific contributions, he is the leading candidate for a Nobel Prize in the area of international trade, with Nobel Laureate Paul Samuelson calling the period spanning 1960s through 1980s the "Age of Bhagwati *et al.*" in the history of international trade literature. As for Jagdish's influence on policy, Lawrence Summers, the former Treasury Secretary and President of Harvard University, has said

> There are literally billions of consumers who do not know his [Jagdish's] name whose real incomes have been higher because of the goods they have been able to purchase at a lower price because of the influence this man has had on the world trading system.

In a similar vein, the citation conferring the Distinguished Fellowship of the American Economic Association states

> Jagdish Bhagwati's intellectual arc has taken him from profound theoretical analyses of international trade to deep insights into the political economy of globalization. No economist now living has displayed so potent a combination of academic analysis and practical wisdom.

Jagdish has always occupied a special place in the lives and hearts of his students (not only those who were his classroom students but also those, like Arvind Panagariya, who learned international trade from his writing and found themselves generously adopted as his students) and vice versa. And since he also has had so many students, there have been numerous celebrations of his milestone birthdays. The present volume emerged from one of the three academic celebrations of his seventieth birthday, this one a conference at the University of Florida.

The chapters in this volume are organized into three parts corresponding to the themes of the festschrift conference. Part I consists of chapters on globalization, wages, and poverty, issues that were the subject of one of Jagdish's earliest contributions to the field of economics (*The Economics of Underdeveloped Countries* (1966), McGraw-Hill, 1966) and which continue to engage his research interests today, for example, in *Trade and Wages* (with Marvin Kosters, AEI Press, 1994) and *In Defense of Globalization*.

Part 1 begins with an evaluative survey (Chapter 1) by T. N. Srinivasan in which he highlights some of the analytical and measurement issues in exploring the trade-poverty nexus and the mechanisms that, in theory, link globalization, and poverty, as well as factors other than trade that might reinforce or mitigate the operation of these mechanisms. Srinivasan's discussion of the issues relating to the meaning and measurement of poverty also enable him to provide a critical assessment of the burgeoning empirical literature on globalization and poverty. He is particularly critical of international comparisons of poverty using a common definition such as $1 per day converted at the purchasing power parity (PPP) at the exchange rate. He rightly notes that such a definition requires an internationally accepted basket of goods that anyone above the poverty line should be able to buy. But a "poverty bundle common to all regions within a geographically and culturally diverse country such as India, let alone for all countries of the world, cannot be meaningfully defined." He goes on to argue, "Deaton [Princeton economist Angus Deaton] is absolutely right in arguing that, because such an internationally accepted bundle does not exist, it does not make sense to simply convert $1/day to local currency values using PPP exchange rates with commodities weighted by their shares in the consumption of the poor. The reason is that doing so makes poverty lines move around with changes in PPP exchange rates arising from world market price changes that have no relevance to the poor."

In Chapter 2, Emma Aisbett, Ann Harrison, and Alix Peterson Zwane survey the evidence on the linkages between globalization and poverty, drawing on the collected works of Jagdish Bhagwati and the results of an National Bureau of Economic Research (NBER) study directed by Ann Harrison, *Globalization and Poverty* (2006). Their study argues for a more subtle understanding of the links between globalization and poverty than is offered by the traditional Heckscher–Ohlin framework that argues that unskilled workers in developing countries are more likely to gain from trade reform. Rather, they conclude, that there needs to be programs to promote human capital development and infrastructure for unskilled workers to have a likely share in the gains from globalization.

Chapter 3, by Eugene Beaulieu, Vivek Dehejia, and Hazrat Omar-Zakhilwal, considers an important hypothesis concerning trade and income distribution first articulated in Bhagwati and Dehejia (1994). The hypothesis is that trade liberalization has made many industries "footloose," that is, small shifts in cost can cause comparative advantage to transfer constantly from one country to another, which may increase labor turnover, which may prompt mobile workers to accumulate fewer skills, which may cause a reduction or stagnation in their real wages. If the effects of such mobility strike less-educated workers harder, the wage differential between educated and less-educated labor will rise. Using Canadian data, the authors argue that the observed relationship between trade and the relative wage of educated to less-educated workers have a closer fit to the Bhagwait-Dehejia hypothesis than the traditional Stolper-Samuelson predictions.

In Chapter 4, Tom Krebs, Pravin Krishna, and William Maloney argue for the importance of studying individual labor income risk and emphasize the need to go beyond aggregate wage statistics in studying the impact of international trade on the labor market. This study examines the effect that trade policy changes have on individuals of differing human capital levels (proxied by education), finding that the effects of trade policy changes on income risk are not monotonically linked with education. Income risk changes due to policy changes may simply be higher at higher education levels.

Part 2 of this volume consists of chapters studying multinational firms, the mechanisms and consequences of international technology transfer, and the political role of multinational firms in the international trade system, topics that are variously related to and inspired by Bhagwati's own work on the questions of factor mobility (Bhagwati and Brecher, 1980; Bhagwati *et al.*, 2004), technological change, and political economy (Bhagwati, 1982; *The World Trading System at Risk* (Princeton University Press, 1991)).

Chapter 5, by Elias Dinopoulos, Ali Gungoraydinoglu, and Constantinos Syropoulos, addresses some questions raised by the signing of the General Agreement on Trade-Related Aspects of Intellectual Property Rights (the TRIPs Agreement), which calls for all World Trade Organization (WTO) members to adopt a set of global minimum standards on intellectual property rights protection. The authors build a model to analyze the effects of strengthening intellectual property protection on growth and poverty. The model generates product-cycle trade; endogenous, long-run, scale-invariant Schumpeterian (R&D-based) growth; and an endogenous wage gap between Northern and Southern workers. The authors find that an increase in intellectual property protection worsens the wage-income inequality between North and South, increases the rate of international technology transfer, and has an ambiguous effect on long-run growth.

In Chapter 6, Kenji Fujiwara, Koji Shimomura, and Kar-yiu Wong analyze the process of technological evolution in an international economy. Motivated by the observation that many developing countries achieve technological catch-up and sometimes even surpass developed countries, they abandon the traditional assumptions in the literature where developed countries exclusively innovate and developing countries exclusively imitate technologies available elsewhere. Endogenizing the decision taken by firms to innovate or imitate advanced technologies allows them to derive conditions under which technological catch-up or surpass takes place.

In Chapter 7, James Markusen and Bridget Strand use recent empirical findings on multinational production, particularly on foreign manufacturing affiliates of US multinationals, to undermine a popular argument against globalization. According to the authors, opponents of globalization adopt a view not uncommon even in traditional economic thinking about multinationals, that international factor-price differences are the primary determinant of foreign direct investment (FDI). According to this view, firms will want to move activities that are intense in unskilled labor from countries where that labor is scarce to countries where that labor is abundant. And in doing so, antiglobalists claim, they undermine existing indigenous markets, destroy competition, and increase “exploitation” of the local labor force. In more recent “horizontal” or “market-seeking” view of FDI and multinationals, it is thought that multinationals create firm-specific (intangible) assets through investments in R&D and learning by doing that can be applied to a variety of locations without any additional costs due to their “public good” nature.

This view predicts that multinational activities will arise between countries at a similar stage in development. Markuson and Strand report that, in fact, US multinationals’ investments in manufacturing affiliates and, indeed, investments from all parent countries flow primarily to high-income countries, that US outward FDI is primarily “horizontal” or “market-seeking,” and that US manufacturing affiliates primarily seek skilled labor. This suggests that international factor-price differences play a subordinate role in FDI, and that globalization may not have the destructive effects its opponents claim.

In Chapter 8, Alan Deardorff analyzes the political economy of rules-setting in the global trading system and describes the role played by corporations in it.

He argues that, unlike in a competitive system, where the profit-maximizing efforts of firms contribute to social surplus, corporate influence on rules may have negative effects. Deardorff cites several examples, including the expansion of the WTO's ambit to cover intellectual property and services, as well the use of rules of origin in bilateral trade agreements, to make his case.

Part 3 of this volume consists of chapters focused on international trade policies and international institutions, areas in which Bhagwati made many contributions and had great influence, for example, *The Economics of Preferential Trade Agreements* (with Arvind Panagariya, AEI Press, 1996); Bhagwati, 1993; *Free Trade Today* (Princeton University Press, 2002; and *The World Trading System at Risk* (Princeton University Press, 2002)).

In Chapter 9, Arvind Panagariya provides a welfare-theoretic analysis of a preferential trade agreement between two small countries. In a literature that has generally been characterized by inconclusive results, this analysis of small unions provides a number of unambiguous theoretical results, including that a union member is necessarily hurt by its own preferential liberalization and that the higher its external tariffs and the larger its imports from the partner, the more it loses from its liberalization.

In Chapter 10, Wolfgang Mayer and Alex Mourmouras analyze the viability of conditionally assisted economic reform programs such as those supported by international financial institutions like the International Monetary Fund (IMF), which must cope with informational asymmetries and special interest politics. This chapter examines what conditions must be satisfied to make conditional assistance programs viable, that is, to assure that the assistance-receiving government not only takes the assistance but also implements reforms, without compromising the country's political and the international financial institution's financial stability.

In Chapter 11, Stephen P. Magee, Kwang-Yeol Yoo, Nakgyoon Choi, and Hong Shik Lee examine several versions of the hypothesis that the "United States is a large country in world trade," a hypothesis, which if validated would provide a theoretical basis for the use of trade barriers to improve US terms of trade and welfare. Using a variety of cross-sectional and time-series tests, however, they find scant empirical evidence supporting the large-country hypothesis, especially in recent years.

In Chapter 12, John Wilson reassesses Bhagwati's (1972, 1973) proposal for "taxing the brain drain" so that developing countries could receive revenue from taxes levied on emigrants residing in developed countries. Using recent theoretical developments on international taxation, Wilson finds that the proposal withstands some important arguments that have been made against it and remains remarkably valid more than thirty years after it was first put forth.

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