Trade and Inclusive Growth

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Abstract
This paper attempts to explain the linkages between trade and inclusive growth or long-term sustained growth along with productivity and employment avenues for both households and firms within a country. Kamel (2013) defined Inclusive growth as growth that is accessed and shared equitably by all segments of society. Inclusive growth then may be understood as a holistic concept at once addressing growth, poverty and inequality. This paper explores the linkages between trade, Investment and Inclusive Growth. A country's level of participation in the regional and global economy and whether or not it is a part of global value chains largely determines impacts on poverty and inequality. This paper attempts to understand and explain the complex relationships which work in transmitting benefits from trade led growth to households. This transmission mechanism is explained through three aspects viz. trade policy related changes, trade facilitation policies and FDI policies. In this process the paper also examines whether South-South trade is better aligned with the needs of developing countries.
The paper concludes that International Integration can promote Inclusive Growth when workers and firms are able to select for themselves which activities they want to engage in and when firms can adopt superior foreign technologies and expertise.
Keywords Trade, Inclusive growth, Investment, International integration.

1.Introduction

Inclusive growth (IG) has been defined many a times in terms of what it is not, eg. an approach commissioned by the Asian Development Bank (ADB) emphasizes that IG is not pro-poor growth or growth with equity. Simply put, IG may be understood as 'growth coupled with equal opportunities'.
Lin(2004) is credited with the first use of the words 'Inclusive Growth', a concept which was earlier known as 'growth with equity' (Fei Ranis and Kuo, 1979).
Lanchovichina and Lundstrom (2013) however argue that IG has a 'distinct character focusing on 'productive employment rather than income redistribution' and that IG has not only the firm but the individual too as a unit of analysis, thereby taking a long-term view of how growth affects individuals and firms within countries through productivity growth and generation of employment. Pro-poor growth is not necessarily inclusive as it does not affect existing inequalities. As Jorge and Rafalowicz (2013) suggest, differentiating between various types of

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economic growth might do more harm than good as policy makers could end up being more concerned with terminology rather than actions and outcomes. It is best therefore to think of IG holistically comprising of equality, social responsibility, poverty reduction and economic security leading to the general well-being of all.

The main channels for achieving IG may be understood as follows:

Channels	**Relative Outcomes**
Creating Economic opportunities	**Lower poverty**
Ensuring access to created opportunities (jobs, education, finance, information, property rights)	**Reduce Inequalities**
Preserving social cohesion	**Improve quality of life**

Income redistribution schemes like subsidies and taxes are insufficient in reducing poverty and ensuring greater equality. Dynamic growth alone does not guarantee IG for which the economy must generate productive jobs and ensure equal access for these to all. It is to be seen how international trade helps in achieving these and the role of institutions, environment and infrastructure as the key prerequisites to creating economic opportunities.

Within the gambit of Trade and globalization, IG has been implicitly given the place of a desired goal as below:

World Bank (2011) :

Trade that facilitates the adaptation and movement of both workers and firms towards sectors with growing demand, and the incorporation of new technologies with the objective of promoting productivity and employment growth of a wide group of workers and firms.

UNCTAD(2007):

A process of globalization that brings more benefits for countries and population sectors previously excluded.

ILO(2008):

Globalization that obtains better results through a more equitable distribution, in order to respond to the universal aspiration of social justice, achieve full employment, secure the sustainability of open societies and the world economy, achieve social cohesion and fight against poverty and inequality

UNDP:

The contribution of firms to human development through the inclusion of the poor in the value chain as consumers, producers, business owners or employees.

ECLAC(2013):

Trade that generates a virtuous circle between the reduction of structural differences and growth that improves the wellbeing of a majority and reduces inequality.

2.Literature Review:

Traditional literature has been closely aligned with the concept of IG as it has focused on the long-term effects of trade reforms on income, employment and wages both within and between countries.

Winters et al. (2004) and Goldberg and Pavcnik (2007) argue that empirical evidence is ambiguous when we see the effects of globalization and trade on inequality and poverty. Harrison et al. (2011) explain that linkages between trade and inequality are open for further study and research partly because of the failure of neo-classical models eg the Heckschler-Ohlin model in predicting income inequality increases in labour-abundant developing countries.

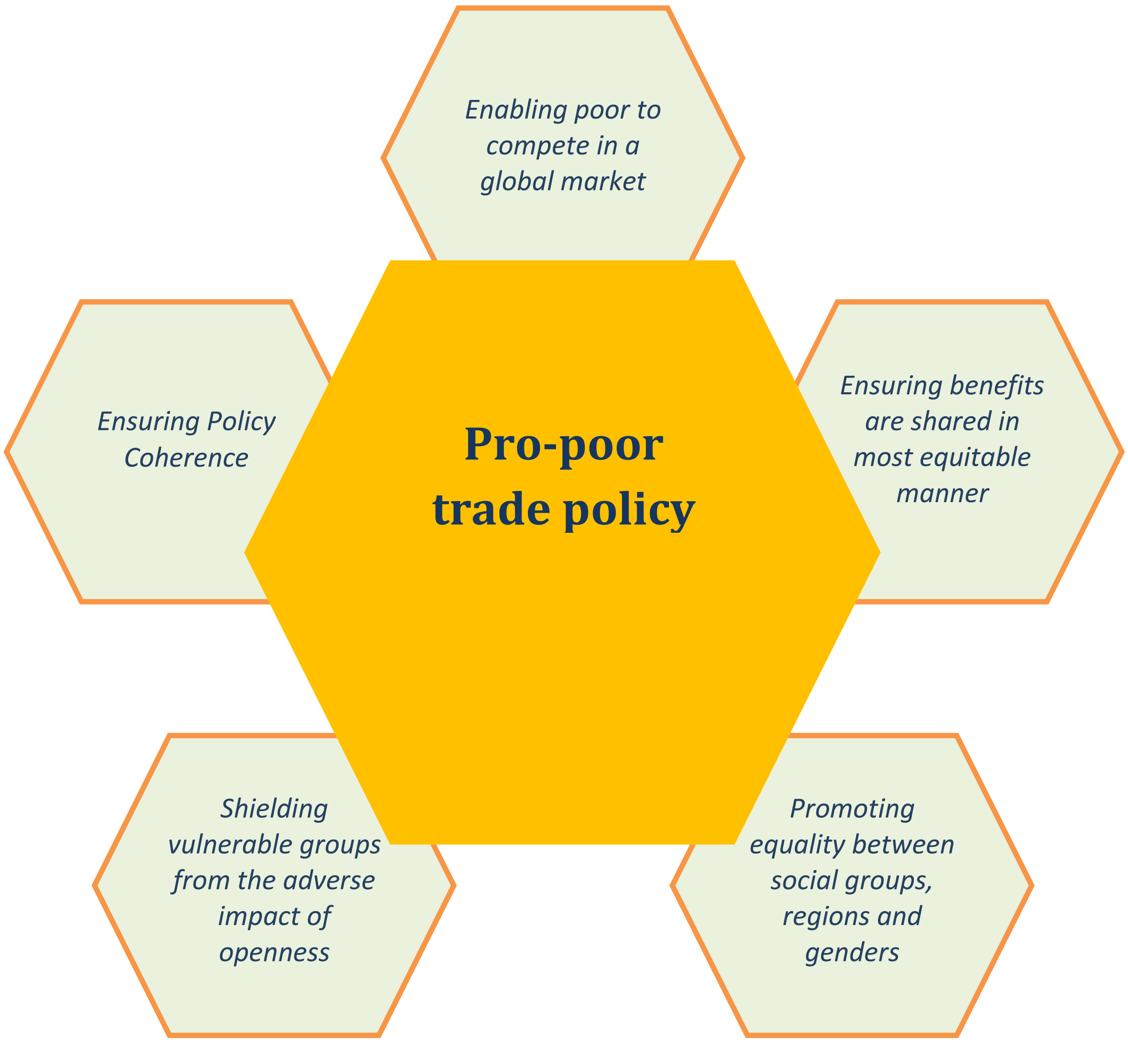
Artuc et al. (2010) is credited with preparing an empirical model to assess labour mobility cost across industries for labourers with data from USA. Similar data has been produced for Turkey (Artuc and McClaren, 2010). Ebenstein et al (2010) showed that labour mobility within occupations but across industries is significant in US and hence cannot be ignored .Thus, worker mobility and choice of employment emerge as important dimensions in the study of trade effects on IG.

It can thus be said that international trade offers opportunities for workers and firms but the extent and distribution of these benefits are determined by their existing capabilities and the prevailing policy environment.

3.Analysis and Discussion

The Asia-Pacific Trade and Investment Report (ESCAP, 2009) described Inclusive Trade policy under the heading of a pro-poor trade policy such that the poor are protected from bearing the burden of trade reforms and are enabled to maximize benefits from trade and investment. Inclusive trade and investment then means that all can participate in and benefit from these activities.

This approach is elucidated in the following diagram:



Source: ESCAP 2009

Trade and Investment alone cannot ensure IG. Complementary policies including positive discrimination for the underprivileged so that equal opportunity is given to all in areas of education, employment, health and information are important. Inclusiveness then may be understood as combining dimensions of employment creation, inclusion of specific groups like women, migrants, unskilled workers, compensation and productivity and their balance for workers and innovations in hi-tech sectors. Also, with respect to food, health and education, level and variety of consumption is as important as the price of consumption. The last aspect that may be added here is that of quality of life.

Traditional approaches which believe that Trade liberalization is the answer to all ills facing an economy based on the assumption of efficiency of global markets and suggesting redistributive measures like taxes miss the above dimensions of inclusiveness and do not realize that liberalization alone cannot and does not automatically generate proper wages and value created by trade may not be shared proportionately by wage earners(UNCTAD, 2012).The problem of displaced labour leading to unemployment, and the negative impacts of trade as demonstrated by the Philippines trade liberalization experience (Intal,2008) cannot be explained by orthodox theories as they fail to acknowledge the inherent mutifacetedness of the concept of Inclusivity or IG.

We now attempt to analyse the effects of trade on IG by taking three dimensions of trade liberalization viz. trade policy, trade facilitation and FDI and observe how they affect households and firms. The most clear-cut effects are those of reallocation of resources leading to relative price changes and income changes on account of increased export opportunities (increase) or import competitiveness (decrease).The 'factory Asia' model of production-sharing where through trade facilitation the cost of imported inputs is considerably reduced many of which are used in export products which is a boon for SMEs is a case in point.

3.1Trade Policy Measures

Trade policy measures refer to efforts by National Governments to influence the movement of goods, services and factors of production from their country to the rest of the world, as also providing access to imports of goods, services and technology while keeping the best interest of domestic producers and consumers in mind. The fulfilment of these objectives often require Governments to restrict cross border movements from and to the country concerned, little realizing that these measures may prove counter-productive as free trade mostly results in production specialization, increasing efficiency and creates access to goods and services not available in the local market improving consumption and production potential. Hence restrictive trade practices should be used sparingly. Sen (1999) suggested that 'people have a right to transact and improve their condition; denying them that right must be adequately justified.'

These justifications may come in the form of negative externalities affecting third parties like pollution, structural adjustment costs and so on. Bhagwati and Srinivasan (2002) believed that these costs fall disproportionately on the poor and therefore aggravate poverty. Similarly, some trade policies create distortions and accentuate market imperfections causing inequalities in addition to those which are a natural byproduct of productivity and preference differentiation (Mankiw, 2013).Thus removing these distortions is the key to a healthier economic base for the country concerned.

Though traditionally trade has been thought of as an 'engine of growth', it cannot be denied that trade policy changes may hurt some segments. Hence the central question then is how to implement trade policy changes to achieve poverty alleviation and how to tackle poverty created in the process. This is answered by bringing into place complementary policies and ensuring that the poor gain from trade liberalization.

Trade liberalization has contributed to Inclusiveness or not can be found out by measuring changes in the household's welfare which may be determined by the effect of change in relative prices on firms(cost-profit ratio, product-mix, wages) and households (price of goods, consumption, income).

Global value chains (GVC) are the new embodiments of interdependence between countries and regions but they are also the harbingers of shocks from trading countries to the local economy. Two variables may be said to determine the intensity of these shocks viz. a) level of sophistication of a country's product, b) level of concentration of its export and import markets. Countries with less sophisticated product baskets are likely to have a lesser share of income and countries with greater geographic concentration of exports and imports will be more prone to shocks from the affected overseas market. This was seen in the recent economic crisis when countries more dependent on supplying intermediate parts to China took longer to recover as their exports suffered heavily.(ESCAP,2009,2011,2012)

South-South Trade

As per UNDP (2013), South-South exports of merchandise and manufacturing have surpassed South-North exports in volume, while also increasing the intensity of skills and technology embodied in them. This South-South trade depended basically on demand from and to the BRICS countries; recently this has shifted to other Southern countries as well. These trading BRICS include Brazil (agribusiness), Russian Federation (technology), India (services), China (manufactures) and South Africa (Auto-aerospace and minerals).Sub-Saharan Africa has fast emerged as a preferred South-South trade destination with both China and India making huge Investments in the area. The fact that goods generally traded in South-South trade are more relevant to the needs of the participating countries, are more affordable and more closely aligned with the principles of energy conservation and sustainable than goods from advanced countries strengthens this trend. These products, thus, offer more development potential if properly acquired, adopted and imitated (UNDP, 2013).The same holds true for services, and tourism deserves a special mention here as it has become one of the world's largest service exports accounting for 30% of all commercial services. As per UNDP (2013), the Asia-Pacific region will see almost a billion tourist arrivals by 2020 as projected by United Nations World Tourism Organization.

Hence South-South trade emerges as a thrust area for developing vibrant value chains and presents an excellent opportunity for cooperation and healthy competition.

3.2Trade Facilitation Measures

Trade facilitation looks at how procedures and controls governing the movement of goods across national borders can be improved to reduce associated cost burdens and maximize efficiency while safeguarding legitimate regulatory objectives. Beyond simplification of regulatory requirements and "at the border" procedures, trade facilitation reforms include enhancing access and efficiency of trade-related services, such as logistics and financial services, as well as improving the overall business environment.

Trade facilitation measures can achieve Inclusiveness by positively impacting trade flows. Simplification of procedures benefits the small and medium entrepreneurs the most, thus creating a level playing field for them and encouraging their participation in International Trade. Groups isolated or excluded can be integrated with the mainstream by creating specific targeted trade facilitation measures for them e.g. access to trade related information for agricultural producers, augmenting women's ability to actively participate in trade and so on. Trade facilitation aims at reducing trade transaction cost and time for exports and imports and can achieve inclusive gains if costs are reduced by faster processing of trade documents and improved information exchange. It is estimated that intraregional trade could increase by over $250 billion (Mann, Wilson and Otsuki, 2004). An ADB-ESCAP study estimated that reducing direct exports costs in Asia to OECD levels could bring a 2.5% rise in per capita GDP in Asia and Pacific countries. Another interesting statistic from the same source tells us that costs associated with inefficient trade procedures account for up to 15% of the cost of goods traded. By reducing this, all concerned stand to gain substantially. Malaysia is a case in point where its customs department has been able to increase its customs revenue by implementing the national single window for one-time submission of transaction information to trade control agencies.

Trade facilitation fosters IG through its impact on domestic trade and business practices. Duval and Uthoktham (2010) found that improving the domestic business (investment) environment has a similar or greater impact on export competitiveness as implementing international trade specific facilitation measures (e.g. reducingexport time).In other words, a firm's international trade efficiency is strongly linked to its domestic trade efficiency. Recent research by Shepherd and Stone, 2013 proves that knowledge flows from GVCs can contribute to upgrading of quality standards in developing country's domestic markets. Thus, the positive spill-over effects of efficient International Trade cannot be overlooked.

It should also be remembered that domestic trade facilitation measures are equally important as there are many firms catering both to the domestic and overseas markets. An example of this would be to create a warehouse in rural areas for food commodities would enable producers to respond to price fluctuations. Creating EPZs or e-choupals, Improvements in ICT (which are estimated to benefit the poor the most through reduction in information search costs) and economic corridors are examples of other trade facilitation measures.

3.3FDI

Simply put, FDI is a controlling ownership in a business enterprise in one country by an entity based in another country. FDI generally is understood to aid economic growth through creation of goods, services, jobs and revenues in the form of tax and capital returns. FDI flows into a country are dependent upon the prevailing investment climate. It is important for Governments to find a balance between regulation and liberalization as too much of either can result in undesirable effects (ESCAP, 2009).

For making FDI inclusive, both the public and private sectors have to be actively involved. While Governments can channelize FDI to disadvantaged groups and place a check on harmful trade activities, private sector can provide training to disadvantaged groups. FDI can contribute to inclusive growth through implementation of responsible business practices and CSR. Impact

Investment is another area for FDI to positively impact IG. ADB defines impact investment as investment that aims not only to secure financial returns, but also to generate positive social and environmental impacts.

Just as the other 2 dimensions above, FDI too needs to be augmented with and supported by complementary policies for leading to inclusiveness so as to benefit the marginalized groups. FDI flows are a powerful source of funds, particularly so for developing economies and guiding FDI along chosen pathways of responsible and dedicated inclusive avenues can be achieved by Government policies in tandem with public-private partnerships leading to increased wages, productivity and skills for everyone.

4. Conclusion

This paper is a modest attempt to understand how and to what extent families and firms are touched by growth as a result of trade. For workers and households, costs of movement across borders and skill acquisitions are crucial issues. For firms, the mechanisms in place which encourage innovation and the ease with which new products can be introduced when relative prices change are of importance. Additionally, information about available foreign technologies, low import taxes on capital goods, and credit market interventions might help small and medium enterprises improve their chances of being able to enjoy the benefits of globalization.

The following findings have emerged from the above discussion: a) Employment opportunities have direct bearing on household incomes and hence consumption of necessities as well as goods and services crucial to a better quality of life. b) Gains and efficiency in production can be achieved by exports c) New technology can be understood, accessed and absorbed through FDI, d) Improvement in wages can remove inequalities of income e) Equality of opportunity for genders is crucial for growth to be inclusive.

Lastly, we must not forget that inclusive growth in fact is sustainable growth. India acknowledged this in the Eleventh Five Year (2007) by incorporating inclusiveness as an important dimension of growth. Inclusive growth at once links microeconomic and macroeconomic determinants of growth making structural transformations as well as changes in economic aggregates crucial for the long-term perspective taken by this approach.

Trade can, thus, as demonstrated by this paper act as an **'engine of inclusive growth'.**

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