

Growth and Trade: The Last Redoubt?

To grow or not to grow, that is not the question. Those in the International Financial Institutions and the Finance Ministries, who dismiss their critics as being “anti-growth”, miss the point and do the debate a disservice¹. There are few people who argue that economic collapse and stagnation is good for the poor, that they have benefited from GDP decline during the transition in Eastern Europe and the Former Soviet Union, or that the reduction in per capita income during the East Asia crisis was to be welcomed. Almost nobody argues that the lot of the poor would have been better if high positive growth rates in China, and in Indonesia before the crisis, had been negative instead. So let us dispense with the straw man.

But there are other questions. How is growth to be generated? It’s the *policies* that are under debate, not growth per se. And will the growth be equitable? Equitable growth is obviously better for the poor, and inequitable growth carries with it the seeds of its own destruction as social tensions undermine the climate of investment and cooperation.

In his new book, Bill Easterly exposes the sorry history of economics and economists in prescribing for growth, as they have staggered from one shibboleth to another². First it was the “financing gap”, then education, then population, and so on. He brilliantly documents the failure of aid and of aid agencies as they followed these fads and threw good money after bad. It is for his public statement on the latter that Easterly is now out of favor with World Bank management.

So what does lead to growth? Easterly is humble about what economists can say, but is not shy about saying it. Some of his conclusions are decidedly unorthodox by the standards of a decade ago. He argues, for example, that high inequality and polarization in societies holds back investment and growth. So does poor governance and corruption. He also highlights the vulnerability of poor economies to natural and economic events outside their control. Easterly deserves high praise for synthesizing and crystallizing the shift in economic thinking over the last ten years.

But there are limits to Easterly’s unorthodoxy. The reader will not find a trenchant critique of privatization in his book. Nor will they find a balanced position on free trade. On the contrary, Easterly is a believer—“free trade arguments are now supported by the experience of the past few decades, which has found that more open economies are richer and grow faster.”

In fact, there is a fair amount of convergence between Easterly’s book and the latest World Bank report on Globalization, Growth and Poverty, which argues, among other things, for good governance, better delivery of education and health services (including involving the poor in decisions that affect their lives), social protection

¹ See Ravi Kanbur, “Economic Policy, Distribution and Poverty: The Nature of Disagreements,” <http://www.people.cornell.edu/pages/sk145/papers/Disagreements.pdf>

² William Easterly, The Elusive Quest for Growth, Cambridge, Massachusetts; MIT Press, 2001.

mechanisms and, of course, integration into the global economy³. On the latter, it could be Easterly speaking when the report says, “Globalization generally reduces poverty because more integrated economies tend to grow faster and this growth is usually widely diffused.”

The proposition on trade and poverty thus has two parts—that integration into world economies causes growth, and that the resulting growth is equitable (or, at least, not inequitable). The first part is a fundamental article of faith among most mainstream economists and policy analysts. After the shocking results of shock therapy privatization without institutions in Eastern Europe and the Former Soviet Union, after the chastening effect of a global financial crisis on the push for capital account liberalization, trade liberalization is the new line in the sand. It seems as though the International Financial Institutions are willing now to concede almost everything from the consensus of yesteryear—except for free trade. And it is for this reason that developing countries may find an unusually sharp focus on this issue as they go in to negotiate with aid agencies.

But what is the evidence that trade causes growth—and not the other way round? Or that there isn’t some third factor that causes both? The World Bank report, and the press releases that accompany it, trumpet the cases of India and China, which have high growth rates and also have more trade than they did a couple of decades ago. But in both these cases, trade liberalization *followed* the upturn in growth, not the other way round. As Dani Rodrik has argued, in a devastating critique of one of the core analytical papers underlying the World Bank report, the causality from trade policy to growth has not been established satisfactorily in these cases and in more general multi-country studies⁴. At least as plausible is the view that it is the reform of national institutions, which creates a local climate for investment and entrepreneurship, which lead to both growth and greater trade.

Is the growth associated with greater trade inequitable, as some have argued? The World Bank report says that “Usually, this is not the case,” meaning by this that on average, across many countries, it is as likely to go one way as the other. But it is cold comfort to policy makers in a country where inequality is going up, to be told that there is some other country where it is going down. Similarly, if vulnerability to the vagaries of the world market increases sharply as the result of opening up, policy makers and civil society activists will understandably argue for a managed process, with opening up being delayed while the social safety net mechanisms are put in place. It is misleading and inappropriate to tag such caution, pejoratively, as “protectionist.”

Complete isolation from the global economy is clearly not good over the long haul for the poor in poor countries. But very few people are actually arguing for such isolation—as few as those arguing for negative growth. What is being debated are the preconditions and rules of that engagement with the global economy, and what is being

³ World Bank, *Globalization, Growth and Poverty: Building an Inclusive World Economy*, New York: Oxford University Press, 2001.

⁴ See Dani Rodrik, “Comments on ‘Trade, Growth and Poverty’”, by D. Dollar and A. Kraay, <http://ksghome.harvard.edu/~drodrik.academic.ksg/papers.html>

expressed is a deep concern that integration is being forced on to poor countries too indiscriminately and at too fast a pace. The lessons of foisting liberalized capital accounts on poor countries were learnt through fin de siecle financial crises. Is it too much to ask for caution on the last redoubt of orthodoxy—trade liberalization?

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