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Trade policies and their impact on inequalities

Note by the UNCTAD secretariat*

Executive summary

Trade reforms have contributed to reducing income inequality between countries, yet they have also been accompanied by polarization in the distribution of income in some places, with significant increases in within-country income inequality. The latter is possibly the main cause behind the current reaction against international trade. Trade is a catalyst for economic growth and development. Accordingly, to respond to inequality, rather than focusing exclusively on productivity and economic growth, policymakers need to focus on encouraging trade and on ensuring that the benefits brought by international trade become more inclusive and responsive to the imperatives under the Sustainable Development Goals. Taking as a point of departure a set of guiding questions received from member States, this note discusses trade policies and their impact on inequalities.

* The present document was scheduled for publication after the standard publication date owing to circumstances beyond the submitter's control.

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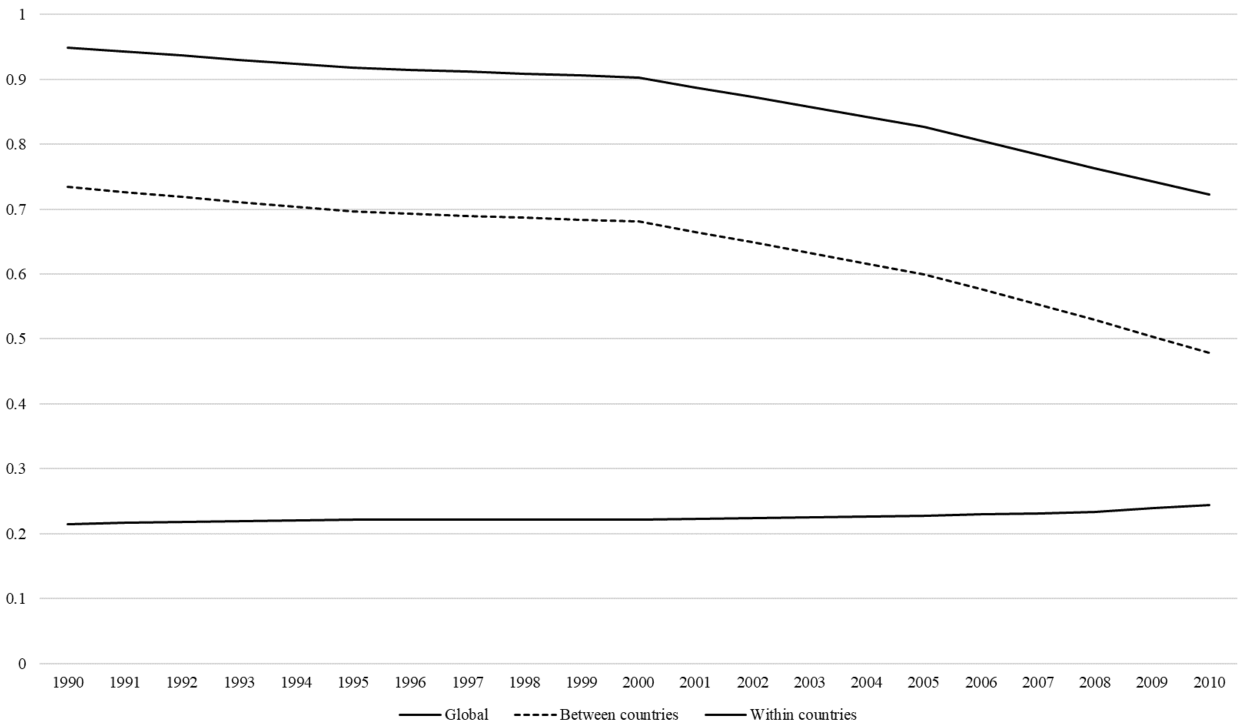
I. International trade in the context of rising inequality

1. In the last four decades, international trade, along with finance and technology, has been instrumental in the development process in many countries. Trade reforms undertaken in developing countries have been accompanied by more rapid economic growth, leading to a reduction in income gaps and lower levels of inequality between countries, observed since the 1990s. This has been due to faster growth in some developing countries, in particular Brazil, China and India, relative to developed countries, as a consequence of their engagement in rapid and deep trade reforms and rapid integration into world markets, which has reduced the overall income per capita gap between developed and developing countries. However, although international trade has contributed to raising living standards in many developing countries, the process of integration into the global economy through trade has also been accompanied by polarization in income distribution, in particular within countries.[1] Some studies suggest that economic inequalities between countries have declined, but have increased within each country on average, explained by a rapid increase in incomes at the top level of income distribution and stagnant incomes at the bottom (see figure).

Theil index of economic inequality



Source: F Bourguignon, 2016, *The Globalization of Inequality* (Princeton University Press, Princeton, United States).

Note: Higher values mean greater inequality.

2. Trade has contributed to decreases in income inequality between countries. In addition, trade is far from the main driver of observed increases in income inequality in both developed and developing countries. Some studies state that an important share of the increase in within-country inequality is driven by factors other than trade, including redistributive, macroeconomic and labour market policies. Trade reforms therefore need to be accompanied by non-trade measures that address some of the unintended consequences of greater integration into world markets.

[1] For an examination of global inequality see Milanovic B, 2016, *Global Inequality: A New Approach for the Age of Globalization* (Harvard University Press, Cambridge, United States of America).

3. The 2030 Agenda for Sustainable Development addresses inequality under Goal 10 of the Sustainable Development Goals. Targets under Goal 10, to reduce inequality within and among countries, include more rapid income growth of the bottom 40 per cent of the population, and ensuring equal opportunity and reducing inequalities of outcome. However, little guidance is provided for trade policy in helping to address the objectives under Goal 10. The only mention of international trade under Goal 10 is in target 10.a, to implement the principle of special and differential treatment for developing countries, in particular least developed countries, in accordance with World Trade Organization agreements.

II. Factors linking international trade to income inequality

4. The effects of international trade on inequality are context specific, yet there are some general factors that illustrate how international trade has affected inequality in the last few decades.

5. The offshoring model of global production, through the fragmentation of production processes across countries, has greatly contributed to the reduction of between-country inequality, creating employment and raising living standards in many developing countries. However, offshoring has also increased within-country inequality in both developed and developing countries. In general, offshoring has increased inequality in developed countries by lowering wages for unskilled labour and blue-collar employment opportunities, and in developing countries by expanding the wage gap between the formal and informal sectors.

6. The diverse impacts of international trade on local communities, such as in rural areas compared with urban areas, also affect inequality. As economic activities within a country are often clustered geographically, some communities have found it difficult to deal with international competition. The adverse effects of international trade have often been highly localized and long-lasting because of interregional and intersectoral rigidities with regard to labour mobility. This implies that trade policies can exacerbate geographical inequalities within countries.

7. The dominance of large firms in global markets has implications for how trade policy affects inequality. The gains from international trade are most frequently captured by large firms, often at the expense of small enterprises, women entrepreneurs, rural agriculturists and fishers. Such actors face various obstacles in benefiting from international trade, including, inter alia, limited information, lack of financing, prohibitive entry costs and underrepresentation in trade policy decision-making. Small firms are thus often unable to compete with larger foreign firms, as the latter have the capacities to overcome such obstacles and gain competitive advantages.

8. Trade policy also influences inequality through market access and entry conditions. International trade is increasingly regulated through non-tariff measures, which affect most traded goods, and have a greater effect on trade than tariffs. Measures such as product standards often limit exports from countries that lack quality control infrastructure and productive capacity. Subsidies and quotas affect international trade in ways that are often detrimental in low-income countries. Such non-tariff measures influence international trade and can have profound effects on inequality, both within and between countries.

9. International trade can further affect inequality by promoting structural transformation. It has been instrumental in the transformation of many countries in East Asia from agricultural to manufacturing economies. This process has contributed to the creation of a thriving middle class in many emerging economies. However, in many developing countries, international trade has taken place in conjunction with increased specialization in the production of commodities and low value-added goods, with little positive effect on the wages of unskilled workers and employment opportunities, including in many commodity-dependent developing countries. This has further exacerbated within country income inequality.

10. Finally, the impact of trade on inequality has differed across countries, and context-specific factors can exacerbate or alleviate outcomes. Differences in outcomes provide

compelling evidence that national, regional and multilateral policies are influential in making trade a means of helping to reduce inequalities.

III. Policy recommendations

11. The Trade and Development Board may wish to consider the following policy recommendations and implementing actions:

(a) In a context of rising within-country inequality, the distributional effects of trade must be a first-order concern. Trade policy should not only pursue efficiency gains but also help poorer countries and small firms and producers, marginalized workers, women and youth to more equally benefit from international trade;

(b) What is needed is not necessarily less trade, but more trade that is inclusive and that provides a greater number of people with access to the benefits of global markets.

(c) Under these broad trade policy recommendations, several promising implementing actions may be considered in order to reduce inequalities, as follows:

(i) It is important to make available up-to-date information to smaller entrepreneurs on market access conditions such as tariff preferences, quotas, rules of origin and standards, as well as on the complex processes linked to regulatory compliance. Smaller producers often have difficulty finding information about standards and ways to comply with them on a cost-effective basis. Trade portals that provide information on processes linked to regulations, such as the UNCTAD Trade Analysis Information System, should continue to facilitate the integration of small firms into the global economy. Compliance costs may be reduced by the inclusion of technical assistance programmes specifically targeted to small firms. A related market entry matter involves voluntary sustainability standards, which should help ensure that workers, agricultural producers and fishers receive fair remuneration, while promoting environmental sustainability;

(ii) It is important to improve the participation of small firms in global markets through export promotion programmes. Well-implemented export promotion programmes have been particularly efficient in supporting small firms in entering export markets and small exporters in diversifying their product and market portfolios. However, export promotion agencies require resources and information that are not always available in developing countries. Development assistance and aid-for-trade financing could provide resources specifically targeted to export promotion programmes for small firms;

(iii) It is necessary to enhance competition, both nationally and regionally, to help small firms benefit from international trade and ensure that increased trade and competition leads to benefits for consumers, for example through lower prices, increased quality and increased choice. Competition authorities should be enabled to investigate and sanction anticompetitive conduct by international firms. International cooperation in competition law enforcement may be encouraged by introducing specific clauses in the competition chapters of bilateral and regional trade agreements. This would also help address the problem of the possible lack of incentives among national competition authorities to restrict the abusive behaviour of large exporters or importers in international markets;

(iv) It is important to promote labour provisions in trade agreements to address the fact that, often, workers in both developed and developing countries, including groups of workers such as women and youth, do not receive their fair share of benefits from participation in global trade. The inclusion of labour clauses is often correlated with a lower incidence of violations of labour rights. Another aspect with regard to ameliorating the positions of workers in the global economy is improving opportunities for workers in increasingly dynamic labour markets, including through education and training programmes. Accordingly, addressing a lack of gender equality is an important dimension of reducing overall income inequality. Efforts being made in this direction could be further strengthened, including, for example, by introducing specific gender and trade-related chapters in new generation free trade agreements, to mainstream gender-related considerations;

(v) It is important to reduce inequality among countries, which requires multilateral cooperation to provide equal opportunities in global trade, in particular for developing countries. This should include safeguarding the open, transparent and predictable multilateral trading system under the World Trade Organization and ensuring that any reform process remains inclusive and equitable. Target 10.a under Goal 10 is to implement the principle of special and differential treatment for developing countries, in particular least developed countries. This is relevant to attenuating adjustment costs for firms and workers and to augmenting the capacities of developing countries to produce, trade and compete. It is also relevant to promoting meaningful market access beyond tariffs, by addressing non-tariff barriers and voluntary sustainability standards; removing harmful fisheries subsides; and addressing tariff escalation and trade-distorting subsidies in agriculture;

(vi) Development assistance is needed to reduce inequality between countries. Linking trade commitments with development assistance programmes is a feasible option, as demonstrated by the Agreement on Trade Facilitation of the World Trade Organization. However, aid-for-trade is only part of the story. Development assistance should be aimed at increasing productive capacity, in particular in developing countries. In this regard, foreign investments should play a more important role in increasing long-lasting productive capacity in developing countries, in particular the least developed countries and small island developing States. South–South cooperation and regional economic integration processes provide a viable avenue for developing countries for boosting regional production and trade in support of industrialization, growth and inclusive development.