

This brief takes a closer look at the relationship between trade, employment and poverty reduction. Rather than being comprehensive on all aspects, it aims to give an evidence-based overview of some circumstances under which trade can lead to employment generation and poverty reduction that is relevant to Sida and its partners. Sida also recognises the complexities in this context and the importance of other thematic areas and aspects related to for instance the environment, climate change and gender equality, which however are not covered in this brief.

INTRODUCTION

International trade is widely recognized as an engine for development, employment generation and poverty reduction.¹ Economies that are more open tend to grow faster, become more competitive, innovate more, and provide better employment opportunities. Studies have shown that trade has a positive impact on incomes, particularly for low-income countries, and that exporting firms tend to perform better in terms of productivity, working conditions and labour rights.² Within the United Nations Agenda 2030, it is recognized that trade plays a vital role in promoting sustained, inclusive and sustainable economic growth, creating jobs, raising incomes and enhancing welfare of people. Trade is linked to several of the Sustainable Development Goals (SDGs) and for instance SDG 17.11 in particular aims to significantly increase the exports of developing countries with a view of doubling the Least Developed Countries (LDCs) share in global exports by 2020.³ In the context of covid-19, trade has also been cited as a key tool in the post-pandemic response and recovery.⁴ However, trade openness also entails short-term adjustment costs for people living in poverty that need to be carefully managed and several factors can constrain people living in poverty from participating in and enjoying the benefits from trade. For instance, institutional



In addition to operating a roadside restaurant where she prepares local foods, Sandra Ocran is the financial secretary for the Initiative Development Ghana. Photo: Jonathan Torgovnik.

capacity, level of education, infrastructure, living in fragile and conflict-affected contexts, gender, being employed in the informal economy or working in a rural area with poor connectivity can all have an impact on poverty alleviation. Identifying and addressing these constraints is key to ensure that trade benefits the poorest and most vulnerable. Policies need to be coherent, systems inclusive and measures put in place to ensure that the benefits from trade are shared widely.

AN OVERVIEW OF INTERNATIONAL TRADE

International trade has expanded rapidly in recent decades, mainly due to globalisation, technological advancements and coordination efforts to reduce trade barriers.⁵ Between 1990 and 2017, the fraction of the world's population living in extreme poverty was reduced by 75 percent owing to economic growth

¹ This brief mainly focuses on resource-related poverty, which refers to not having access to, or power over, resources that can be used to sustain a decent living standard, meet basic needs and improve one's life. As stated in Sidas multidimensional poverty analysis (MDPA) tool, poverty is a complex phenomenon where resource-poverty is only one dimension. Other dimensions include poverty in relation to i) opportunity and choice ii) power and voice and, iii) human security.

² WTO and WB, 2015. *The role of trade in ending poverty*, p. 21-23. WB: Washington D.C.; OECD, 2018. *Market opening, Growth and Employment*, p. 19. OECD: Paris.

³ SDG target 17.11 of doubling the LDCs share of global exports by 2020 has not been fulfilled. Based on UNCTAD, 2021. *International trade in developing countries*. SDG Pulse. Accessed online 2021-12-10.

⁴ WTO and WB, 2021. *The role of trade in developing countries' road to recovery: joint policy note*. WTO: Geneva.

⁵ IMF, 2001. *Global Trade liberalization and developing countries*. IMF: Washington D.C.

that was largely underpinned by trade.⁶ During the same time period, trade as a share of global GDP grew from 39 to 57 percent. This helps explain the strong correlation between increased exports (goods and services) as a share of global GDP and the decline in the number of people living in extreme poverty globally (figures 1 and 2).

Today, developing countries are playing an increasingly important role in international trade. In 2020, developing countries accounted for 42 percent of total exports, up from 16 percent in 1990.⁷ Many developing countries, especially in East Asia, have successfully used trade as an instrument to increase productivity, create jobs and diversify their economies.⁸ Box 1 looks at Vietnam as an example to illustrate this point.

Figure 1: Poverty headcount ratio at \$1.90 a day (% of population)

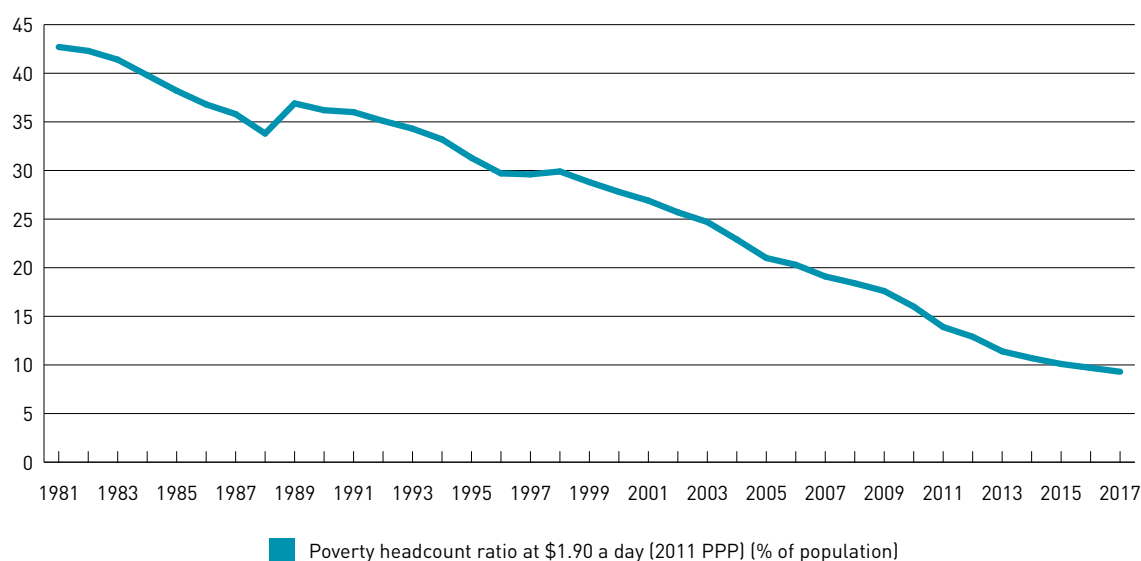
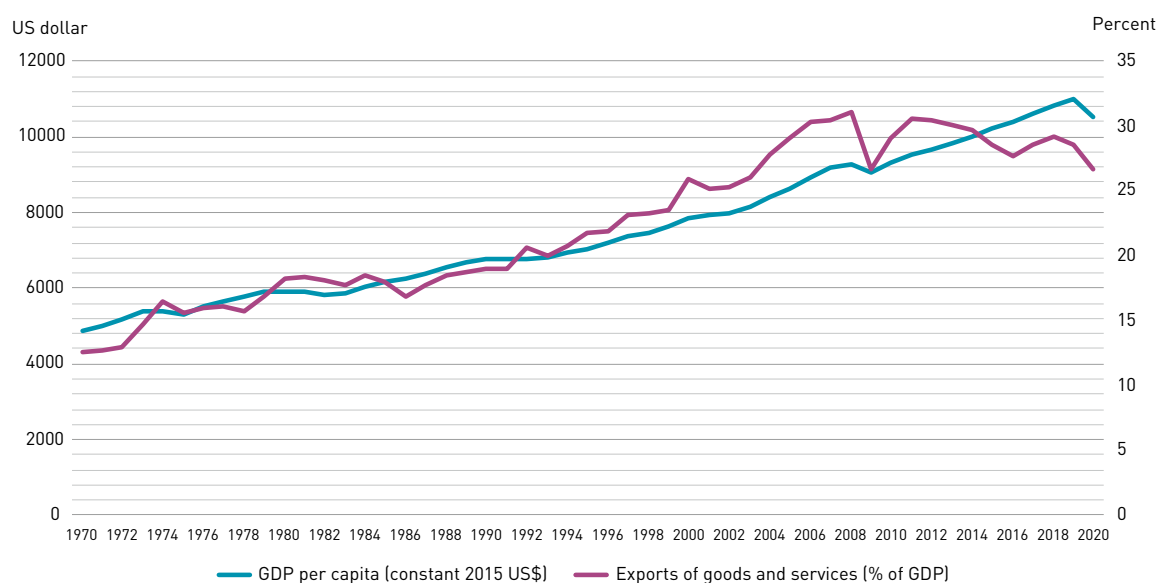


Figure 2: GDP per capita and world exports



Source: World Bank Data

⁶ WB, 2021. *Spreading the gains from trade more widely: press release no 2021/147/EFI*.

⁷ UNCTAD, 2021. *International trade in developing countries*. SDG Pulse. Accessed online 2021-12-10.; WB., (2021) *Spreading the gains from trade more widely: press release no 2021/147/EFI*.
⁸ WTO and WB, 2021. *The role of trade in developing countries' road to recovery: joint policy note*. WTO: Geneva.

Box 1. Trade, employment and poverty – an example of Vietnam

Vietnam has in the past two decades intensified its participation in global value chains (GVCs) and undergone a major reallocation of labour from agriculture to services and manufacturing. Trade as a share of Vietnam's GDP doubled between 1998 and 2018, and has also experienced a substantial reduction in poverty: the share of people living on less than US\$3.20 a day declined from about 68 to 6.6 percent.⁹ The trade expansion also led to improved wages and spurred a reallocation of labour from informal to formal jobs in sectors and areas more exposed to higher exports. Similar trends could be identified for other members of the Association of South East Asian Nations (ASEAN) as well as countries such as India and China.¹⁰

However, importantly, evidence also shows that such success-stories do not apply to all developing countries, and not to all groups within countries. LDCs in particular have been largely left behind by globalization and still make up only about 1% of global trade.¹¹ This underscores the need for a concerted effort to make trade more inclusive, not least for people living in LDCs.

THE RELATIONSHIP BETWEEN TRADE, EMPLOYMENT AND POVERTY

Basic economic theory states that openness to trade leads to economic growth because it allows countries to use their resources more efficiently by specializing in the production of goods and services, which they can produce more cost-effectively while importing the others. Integration into global markets expands the opportunities for domestic companies to grow, allowing for greater economies of scale. Trade also leads to long-term growth by enabling global sharing of know-how and technological advancements.¹² By increasing international competition, trade also makes goods and services more affordable for the poor as consumers. With the expansion of export sectors and structural changes in the economy, more and better productive employment opportunities can be created.

Studies have also shown that trade has a positive impact on raising average incomes and that low income regions experience the strongest increases in wage growth.¹³ Besides, exporting companies are usually more productive and pay higher wages than

the average company. In addition, when studying different economies, open economies outperform closed ones in working conditions and labour rights.¹⁴ As such, trade can work to reduce poverty through its positive effects on productive employment and decent work, which in turn creates opportunities for improved livelihoods.

While this relationship is strong, it is complex and not automatic. Trade liberalization, like technological advancements, will in the short-term simultaneously lead to job creation, destruction and reallocation both across and within sectors.¹⁵ This entails adjustment costs for firms and individuals who are affected negatively in the process. Moreover, developing countries are still disproportionately burdened by structural barriers such as ineffective governance, corruption, low-levels of education, lack of access to financial services and poorly defined and protected property rights. This inhibits such economies' capacity to transform and reallocate resources into more productive sectors. Efforts to address these constraints and minimize the adjustment costs are key to facilitating sustainable trade-driven growth. Accordingly, trade policy should be implemented in conjunction with complementing policies that are adapted to the country context and also recognizing the specific constraints faced by the most vulnerable groups.

At country level, research has confirmed that policy strategies in support of inclusive and sustainable economic growth where people living in poverty can contribute to and benefit from trade include the following:¹⁶

- **Sustained investment in education, health and infrastructure**

A healthy and skilled workforce is essential in enabling employment growth and structural change. Attracting investment in infrastructure, including information and communication technology (ICT), is also important. In addition, time and costs of transportation still presents one of the main barriers hampering trade expansion in developing countries.

- **Functioning and inclusive financial systems**

A well-functioning financial system, which facilitates transactions and allows people living in poverty to benefit from financial services such as loans, saving products and insurance is fundamental.

- **Functioning and equal labour markets**

Policies should drive labour market reform, which fosters domestic competition and innovation and

9 WB, 2021. World Bank Data: Poverty Headcount at \$3.20 a day (2011 PPP) [% of population] for Vietnam; WB, 2021. World Bank Data: Trade [% of GDP] for Vietnam.

10 WB, 2021. *The Distributional Impacts of Trade-Empirical Innovations, Analytical Tools, and Policy Responses*, p.52. WB: Washington D.C.

11 WEF, 2019. *5 ways to boost sustainable trade in the world's poorest countries*. WEF Agenda. Accessed online 2021-12-10.

12 Kommerskollegium, 2021. *Varför handlar vi med omvärlden*, p 6. Kommerskollegium: Stockholm.

13 OECD, 2018. *Market Opening, Growth and Employment*, p 19. OECD: Paris.

14 OECD, 2019. *Trade Policy Brief*. OECD: Paris.

15 WTO and WB, 2015. *The role of trade in ending poverty*, p. 23. WB: Washington D.C.

16 See for instance WTO and WB, 2015. *The role of trade in ending poverty*, p. 47. WB: Washington D.C.



In Dhaka, the tailor moves out onto the street.
Photo: Elisabeth Lorenz/Sida.

facilitates a shift towards more competitive and sustainable economic sectors and activities. This can for instance include a shift towards a greener economy. Labour markets should also be inclusive, fostering gender equality and labour rights.

- **Ensuring macroeconomic stability**

Through policy instruments, governments can smooth out economic up- and down-turns to create a stable macroeconomic environment, which helps maximize the positive impact of trade openness on growth.

- **Good governance, rule of law and secure property rights**

Well-functioning institutions are crucial in attracting Foreign Direct Investment (FDI) and spreading the benefits of trade to people living in poverty. Institutions need to have the capacity to develop and implement trade policies in a way, which is efficient, non-corrupt, transparent and inclusive, ensuring the rule of law and the securing of property rights.

To enable a wide distribution of the trade-induced gains, research states that these broader socio-economic policies should be complemented by more targeted policies, which specifically target people living in extreme poverty.¹⁷ These targeted policies are shown to serve best if underbuilt by a country-level analysis of the characteristics of the people living in extreme poverty and the key factors that constrain their ability to gain from trade opportunities. Some main cross-cutting factors, which have been identified include: living in a conflict-affected region, being a woman, being employed in the informal economy or working in rural areas with poor connectivity. In

sum, maximizing the benefits of trade requires action both by supporting wider socio-economic (enabling) policies and by adopting more targeted approaches to tackle factors, which hinder people living in poverty from fully taking advantage of the productive employment opportunities that are created by trade expansion and that can lead to improved livelihoods.

IMPLICATIONS OF COVID-19

The Covid-19 pandemic has triggered the deepest economic recession since the second world war with a global contraction of GDP at 3.3 percent in 2020.¹⁸ With a loss of more than 250 million jobs in 2020 and pushing around 100 million people into extreme poverty, the pandemic is also a massive setback in global efforts to reduce extreme poverty. Initially, the pandemic caused major disruptions in global trade with a significant downturn in production and consumption, and great challenges for global value chains (GVCs).

However, trade has experienced a rapid recovery. While the recovery for trade in services has been slower, trade in goods during the first quarter of 2021 was higher than the pre-pandemic level.¹⁹ This has helped drive economic recovery in many countries. Especially for developing countries with limited ability to pass fiscal stimulus packages (such as increased public spending), trade is a key source for accelerating recovery.²⁰

While the strong rebound of trade has been seen to put stress on logistical systems and create some supply-side bottlenecks, the World Trade Organization (WTO) does not foresee that this will have large impacts on the global trade recovery. The evidence so far is that economies with diversified trade structures, high integration in GVCs, and with less dependence on services that require in-person interaction, such as tourism, have recovered faster from the pandemic. The pandemic has also shown that there are mechanisms for maintaining GVCs during a shock, enhancing resilience and enabling a strong recovery. These mechanisms include for firms to diversify sources of supply, raising inventory and capacity reserves as well as fostering a flexible production across sites. During a recession, GVCs can moreover transmit a recovery that takes place in one part of the world to other parts through value chains.²¹

Recent World Bank and WTO research has also found that policies aimed at 'increasing economic resilience' by reducing trade integration and reshoring production will often have the opposite effect and lead to a slowdown in recovery, both in developed and

17 WTO and WB, 2015. *The role of trade in ending poverty*, p. 21-23, WB: Washington D.C.

18 WTO and WB, 2021. *The role of trade in developing countries' road to recovery: joint policy note*. WTO: Geneva.

19 UNCTAD, 2021. *Global trade's recovery from covid-19 crisis hits record high*. Accessed online 2021-12-10.

20 WTO and WB., (2021) *The role of trade in developing countries' road to recovery: joint policy note*. WTO: Geneva.

21 Ibid.

developing countries.²² It is also evident that a crisis and a subsequent period of recovery is a particularly bad time to increase trade barriers as the demand for imports may increase while exports can be crucial for sustaining economic activities and ultimately maintaining jobs and income. Understanding and addressing vulnerabilities of developing countries is also key for their possibilities to prepare for trade shocks.²³ The continued expansion of international trade is an important factor for the recovery from Covid-19 – including for maintaining and retaining jobs – and for building greater resilience for future shocks.

WHAT IS THE FUTURE ROLE OF TRADE IN POVERTY REDUCTION?

Despite the adjustment costs and context-specific constraints, which can inhibit trade-induced gains for people living in poverty, the arguments for trade liberalization are very strong. Economic growth is a prerequisite to ending extreme poverty and trade is a critical enabler of growth, facilitating the creation of new and better job opportunities. Sustained economic growth and development has rarely, if ever, been achieved by countries that are closed to international trade and foreign investment.²⁴ Particularly for low-income countries that are constrained by a small domestic market, the expansion into regional and global markets is often crucial in creating employment opportunities and spurring economic growth. While over the past decades, great progress has been made in reducing trade costs and spreading the benefits of trade more equally, it is also clear that more still needs to and can be done. Box 2 looks at the potential that lies in trade in Sub-Saharan Africa.



Miner in Botswana. Photo: Ylva Sahlstrand/Sida.

Box 2. The potential of trade in Sub-Saharan Africa

With over a billion inhabitants and the fastest growing population globally, the Sub-Saharan African (SSA) market has great potential. However, poverty is still widespread and the continent hosts 33 out of the 44 LDCs in the world and 27 out of the 28 poorest countries.²⁵ This makes SSA a main region of focus in the efforts to achieve the UN Sustainable Development Goal on doubling LDCs' share of exports by 2020 and eradicating extreme poverty by 2030. International trade has been identified as a key tool for accelerating economic growth and poverty reduction in SSA, as reflected in the rapid transition towards a more integrated African market in recent years. 2021 has marked the launch of the African Continental Free Trade Area (AfCTA) under which the 54 African Union member states have agreed to create a single market for goods and services. A recent world bank study on the impacts of the AfCTA underscores the great potential of eliminating trade barriers within the region. It estimates that 30 million people can be lifted out of extreme poverty with a 10 percent increase in wages above baseline by 2035, with particular gains for women and lower-skilled workers.²⁶

The potential of trade to improve livelihoods in Africa has also been highlighted by several recent empirical studies. A study by the International Labour Organization (ILO), which looked at manufacturing in 47 African countries, found that employees in export-oriented firms earned 16% more than workers in non-exporting firms due to productivity gains through economies of scale.²⁷ Another recently published study, examining the relationship between trade liberalization and poverty alleviation in 21 African countries, confirms that trade openness indeed has a significant positive impact on poverty reduction through its effect on economic growth.²⁸

SIDA'S WORK WITH TRADE

The Swedish Policy Framework for Development Cooperation and Humanitarian Assistance recognizes free and fair trade as an important part of the strive towards sustainable and inclusive economic development. Sida is an active donor in the international Aid for Trade initiative, which aims to help developing countries, particularly LDCs, to trade by addressing supply-side capacity and trade-related infrastructure constraints that hinder countries from fully engaging in and benefiting from trade. In 2020, Sweden contributed SEK 3.7 billion to the international Aid for Trade Agenda and the latest EU Aid for Trade Progress

22 Ibid.

23 Ibid.

24 Love, P. and Lattimore, R., 2009. *Trade and Development in International Trade: Free, Fair and Open?* OECD Publishing: Paris.

25 WB, 2018. *Year in review: 2018 in 14 charts*; UNDP Africa, 2021. *Graduation of African Least Developed Countries (LDCs) - Emerging issues in a new development landscape*.

26 WB, 2020. *The African continental Free Trade Area: Economic and Distribution Effects*. WB: Washington D.C.

27 ILO, 2018. *Exporting, Importing and wages in Africa: evidence from matched employer-employee data*.

28 Onakoya, A., Johnson, B. and Ogundajo, G., 2019. *Poverty and trade liberalization: empirical evidence from 21 African countries*.

Report placed Sweden as the fifth largest contributor to Aid for Trade among EU member states. Empirical studies have also shown that every dollar invested in Aid for Trade generates nearly twenty dollars of exports in LDCs and that the effects from Aid for Trade on employment as well as poverty reduction are positive, especially in LDCs – the employment effects are also particularly strong for women.²⁹

Through its Aid for Trade support, Sida works with several aspects raised in this brief. The work includes addressing some of the policy strategies for inclusive and sustainable economic growth where the people living in poverty can contribute to and benefit from trade mentioned above, including i) good governance, rule of law and securing of property rights, ii) functioning and inclusive financial systems as well as iii) functioning and equal labour markets. For instance, through targeted trade-related interventions such as trade policy capacity building, supporting the implementation of trade agreements as well as supporting regional integration. In recent years, the largest share of Sida's Aid for Trade support has also been directed to multilateral organisations such as the World Bank and International Trade Centre (ITC). For instance, through focused support towards making Micro Small and Medium Sized Enterprises more competitive and integrate them into the global economy, the ITC

contributes to raising incomes and creating job opportunities in low-income countries.

In terms of geographical distribution, Sub-Saharan Africa continues to be the region towards which the largest share of Swedish Aid for Trade is directed. Sida supports various initiatives aimed to unlock the region's untapped potential for delivering poverty reduction through free and fair trade.

In a wider sense, Sida also works with creating inclusive and functioning market systems that operate in a way that meet the needs of people living in poverty and allows them to benefit from economic development. This entails making markets accessible, increasing the economic choices and opportunities and creating a vibrant private business sector.

FURTHER READING

OECD website on [Trade and jobs - OECD](#)

Sida, 2019. [Gender Equality and Trade](#). Sida: Stockholm.

UNCTAD SDG Pulse website: [International trade in developing economies](#).

WTO and WB, 2015. [The role of trade in ending poverty](#). World Trade Organization: Geneva.

WTO and WB, 2021. [The role of trade in developing countries' road to recovery: joint policy note](#). World Trade Organization: Geneva.

²⁹ OECD, 2013. *Succeeding with Trade Reforms: The Role of Aid for Trade*; Durowah, O., 2017. *The role of aid for trade and foreign direct investment in poverty reduction: a panel data analysis of 91 developing countries*; Kimm Gnanngnon, S., 2018. *Aid for Trade and Employment in Developing Countries: An Empirical Evidence*.