

## 2020 FOCUS BRIEF on the World's Poor and Hungry People

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### TRADE LIBERALIZATION AND CHILDREN

#### Understanding and Coping with Children's Vulnerabilities

Javier Escobal

The arguments in favor of trade liberalization are well known: it promotes the efficient allocation of resources through comparative advantage, allows the dissemination of knowledge and technological progress, and encourages competition. Trade liberalization is likely to have a major impact on the lives of poor children and their families. Although this effect may be positive in the long run, the development literature recognizes that it may have a negative short-run impact in sectors that are unable to adjust rapidly enough to the new policy context. Vulnerable groups, especially children, may be affected in a variety of ways based on the effect on household livelihood and the intrahousehold distribution of power and resources. Complementary policies need to be put in place in order to cope with these vulnerabilities.

Four dimensions associated with the research on the effects of trade liberalization are relevant to the well-being of children. First, trade liberalization changes the relative profitability of economic activities, so some groups within a society may benefit while others lose—at least in the short run. Second, the effects of trade liberalization occur gradually over time. Third, trade liberalization affects not only household welfare, but also the welfare of individuals within households, so vulnerable groups may exist even in households that can benefit from trade liberalization. Fourth, trade liberalization has fiscal impacts that may generate reallocation in public spending. It is also important to note that the complex interactions of these dimensions make the welfare impact of trade liberalization difficult to trace.

#### Long- versus Short-Term Effects

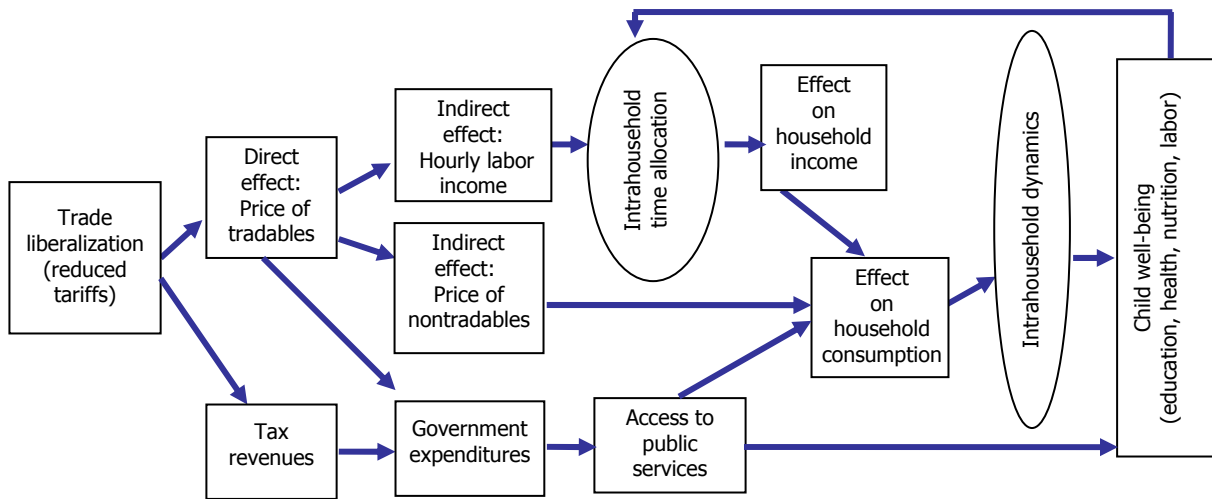
Trade liberalization has both direct and indirect effects on the well-being of children (Figure 1), and these effects operate both short- and long-term. A first effect relates to the impact of trade liberalization on the domestic prices of goods and services. Among small developing countries, trade liberalization may directly affect the prices of tradable goods due to direct interaction with

international prices. In turn, these price changes induce further changes in the prices of nontradable goods. Similarly, the change in the prices of consumption goods induces a change in hourly labor income, which in turn affects the allocation of household and intrahousehold time and resources. A second link consists of the effects of these changes (in consumption good prices and hourly labor income) on both household consumption and household income. In addition to these effects, the reduced tariffs that trade liberalization brings about will also affect tax revenues and hence the supply of goods and services provided by the government. Depending on the intrahousehold distribution of power and resources, all these changes may affect the allocation of children's time among work, school, and play; their access to health services; and their consumption of goods and services. Finally, given that children are also considered a resource, child labor, health, or nutrition outcomes will feed back into household decisionmaking processes. This feedback effect may have implications for whether or not a household engages in opportunities brought about by trade liberalization.

#### How Trade Liberalization Affects Children's Welfare

Although an enormous body of research deals with the effects of trade liberalization on economic growth and household welfare, little research focuses on the effect of trade liberalization on child welfare. The most researched topic is the impact on child labor. As trade liberalization has accelerated, attempts to ban child labor have increased through the introduction of harmonized international child labor trade regulations. Several authors have noted, however, that using trade restrictions to deter the exploitation of foreign child labor may have had the opposite effect: children can be negatively affected as the worst types of child labor increase, especially in cases where export earnings are severely reduced due to the introduction of export restrictions.

**Figure 1—Key Short-Run Linkages between Trade Liberalization and Child Welfare**



Source: Adapted from Figure 6 in J. Escobal and C. Ponce, "Trade Liberalization and Child Welfare: Assessing the Impact of a Free Trade Agreement between Peru and the United States," Young Lives Working Paper No. 36 (Oxford: Department of International Development, University of Oxford, 2008) and Figure 1 in N. Jones, N. N. Anh, and N. T. Hang, "Trade Liberalization and Intra-household Poverty in Vietnam: A Q2 Social Impact Analysis," Q-squared Working Paper No. 46 (Toronto: Centre for International Studies, University of Toronto, 2007).

In general, the effect of trade liberalization on child labor is ambiguous. The effect will depend on changes in the opportunity costs of children's time and whether an income effect on child labor is brought about by changes in employment or wages. Growing evidence indicates that, in many cases, trade reform may reduce the incidence of child labor through its income effects. However, short-term vulnerabilities do arise and may divert children from school to work.

The short-term impact of trade liberalization over child labor and schooling decisions is critically mediated by two key factors: whether or not the household has credit constraints and whether or not female labor participation increases due to trade liberalization. Under the presence of credit constraints, short-term vulnerabilities may induce parents to withdraw children from school even if the long-term income effect generates a positive incentive in favor of schooling. On the other hand, increased female labor participation—whether from new access to labor opportunities provided by trade liberalization or a need for additional income due to its negative effects—may have important effects on child welfare, especially for girls. Under increased female labor participation, childcare may become the responsibility of older siblings, reducing their chances of attending school.

If trade liberalization reduces school attendance in the short run, it will also have long-term implications for the intergenerational transmission of poverty. Even if the policy shock does not induce changes in schooling and time spent on education, it may reduce the effective

accumulation of human capital through cuts in expenditure on education, from both the state and the family, which may also have long-term implications for children's well-being.

### Young Lives Evidence

Young Lives, an international research project investigating the changing nature of childhood poverty over a 15-year period (starting in 2002), provides a unique opportunity to study the short- and long-term effects of trade liberalization on children's well-being. The project has studied the relationship between trade liberalization and child welfare for two countries currently moving toward trade liberalization and for which the project is collecting longitudinal data: Peru and Vietnam. For Peru, the project studied the likely impact of a free trade agreement (FTA) with the United States, while for Vietnam, it is tracing the impacts of increased trade liberalization since Vietnam's entry into the World Trade Organization in November 2006.

Peru and Vietnam have moved toward more open economies in the past two decades. The effect of this move has been impressive in terms of higher growth, lower inflation, and sustained foreign investment. Further, these macroeconomic trends have been accompanied by reduced poverty in Vietnam, though this trend has been much less pronounced in Peru. In both countries, however, income inequality is increasing (Table 1).

In Peru, Young Lives studied school attendance and the time children had available to study and play (as opposed to having to work) as indicators of skill formation. The project also

looked at the effect of an FTA on the employability of the mother or caregiver, which may increase the burden of children (especially girls) in performing household chores and caring for younger siblings. Young Lives research found that both boys and girls—especially those living in Peruvian rural areas—may be vulnerable to reduced school attendance if complementary policies are not put in place alongside FTA tariff reductions.

**Table 1—Trade Liberalization and Poverty in Peru and Vietnam**

Country/Indicator	Early 1990s	Late 1990s	Early 2000s
<b>Peru</b>			
Real GDP growth (per year)	2.1	6.8	4.8
Trade openness (X+M/GDP)	20.6	26.0	32.7
FDI stock/GDP	4.0	13.1	19.4
Inflation (% per year)	132.0	8.6	3.7
Poverty rate	54.5	42.7	48.0
Extreme poverty rate	23.5	18.2	14.9
Inequality (Gini index)	0.388	0.386	0.403
<b>Vietnam</b>			
Real GDP growth (per year)	2.3	8.1	5.5
Trade openness (X+M/GDP)	50.9	77.5	104.0
FDI stock/GDP	0.9	4.0	2.1
Inflation (% per year)	67.5	3.2	4.0
Poverty rate	58.1	37.4	28.8
Extreme poverty rate	24.9	15.0	10.9
Inequality (Gini index)	0.329	0.350	0.367

Sources: For Peru: Central Reserve Bank, Instituto Nacional de Estadística e Informática, and Instituto Cuanto; for Vietnam: Vietnam General Statistical Office, World Bank, and IMF staff estimates.

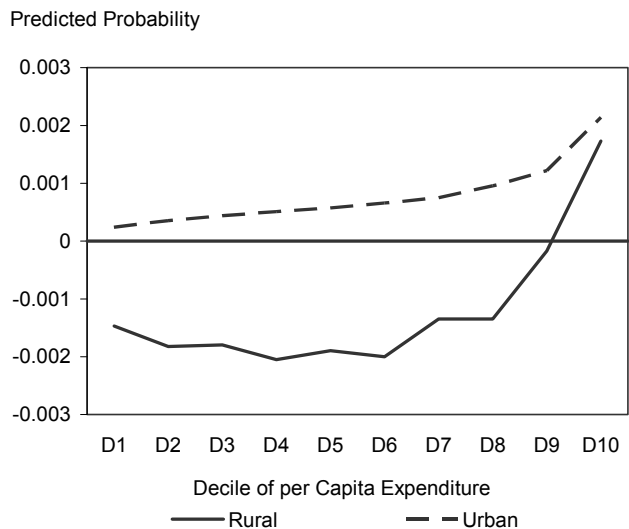
Notes: GDP indicates gross domestic product; FDI, foreign direct investment; X, exports; and M, imports.

School attendance may be affected by two factors. First, household incomes may be negatively affected, at least in the short run, and parents may have difficulty meeting education expenditures (an income effect), and, second, in those sectors where employment opportunities for women increase, it will become more likely that mothers or caregivers will engage in wage-dependent activities, requiring the transfer of household responsibilities to school-age children (a substitution effect). In the case of urban boys and girls from Peru, however, the Young Lives study found that, on average, trade liberalization is likely to bring additional income into their households, so the probability of their attending school may in fact increase.

Trade liberalization may reduce the probability of school attendance for children of households in rural areas (Figure 2), and this reduction will be larger for poor households. In contrast, however, trade liberalization may have a positive, although

small, effect on the probability of school attendance among children of households in urban areas. It is interesting to note that research indicates that the least-poor children (the upper 20 percent of the expenditure distribution) are the ones with the largest increase in the probability of attending school.

**Figure 2—Change in the Probability of School Attendance for Children in Urban and Rural Peru**



Source: J. Escobal and C. Ponce, "Trade Liberalization and Child Welfare: Assessing the Impact of a Free Trade Agreement between Peru and the United States," Young Lives Working Paper No. 36 (Oxford: Department of International Development, University of Oxford, 2008).

In Vietnam, the Young Lives study undertook both quantitative analysis, through a longitudinal survey, and in-depth qualitative analysis based on two key sectors that are expected to be affected by trade liberalization—aquaculture and sugarcane. After looking at three key aspects of children’s well-being (child work, educational attainment, and health status) the study concluded that those likely to be vulnerable in an environment of greater economic liberalization are girls in general; children of ethnic minority, female-headed, low maternal education, and impoverished households (due to their susceptibility to economic shocks); and communities with highly concentrated poverty.

### Policy Implications

The effects of trade liberalization are difficult to trace and are mediated by regional and local characteristics, including differentiated transaction costs and market imperfections, that affect the impact of international prices on local prices. It is therefore safe to say that the effects of trade liberalization are uncertain and that the perceived

“losers” in fact may not be affected to the degree expected if local conditions act as a buffer. Similarly, those anticipated to be the “winners” may not benefit as much if they are adversely affected by market imperfections. The fact that clear winners and losers cannot be identified in advance does not mean that policymakers cannot devise appropriate policies to address the potential negative short-term effects of trade liberalization. It does mean, however, that the uncertainty of outcomes needs to be taken into account.

Policy options to be considered to address vulnerability to possible negative trade liberalization impacts include the following:

- At the macroeconomic level, a contingency fund can be maintained for use in case of a negative event, whereby “losers” can be identified and appropriately compensated.
- At the household level, conditional (or unconditional) cash transfer programs can be instituted to redress liquidity constraints resulting from shocks induced by trade liberalization.
- At the individual level, differentiated incentive mechanisms can be employed to reduce the gender imbalance, whereby girls face a disproportionately higher risk of being negatively affected.

When determining cash transfer amounts, governments should provide higher amounts to girls as a safeguard against a widening of the gender gap in school attendance. In this context, conditional cash transfer programs, such as *Juntos* in Peru, may play an important role in reducing children’s vulnerability to the negative effects of trade liberalization. On the other hand, an

increase in the number of childcare centers may also be an important factor in reducing the probability that children will be required to take on greater domestic responsibilities as more adults enter the labor market in response to new economic opportunities brought about by trade liberalization. In Peru, the *Wawa Wasi* program—a public program targeting poor children between the ages of 6 and 48 months—is expected to be expanded to cope with a higher demand for childcare services in areas where female labor participation is likely to expand.

### Concluding Comments

Research clearly shows that children are indeed susceptible to the negative effects of trade liberalization and that they belong, in general, to the same types of vulnerable groups identified in many other development and poverty contexts. The key implication is that poor, marginalized, and disempowered households are least likely to participate in or benefit from trade liberalization policies targeting economic growth, so the children of these households are the most at risk from negative effects.

**For Further Reading:** J. Escobal and C. Ponce, “Trade Liberalization and Child Welfare: Assessing the Impact of a Free Trade Agreement between Peru and the United States,” *Young Lives Working Paper No. 36* (Oxford: Department of International Development, University of Oxford, 2008); N. Jones, N. N. Anh, and N. T. Hang, “Trade Liberalization and Intra-household Poverty in Vietnam: A Q2 Social Impact Analysis,” *Q-squared Working Paper No. 46* (Toronto: Centre for International Studies, University of Toronto, 2007); P. Pereznieta and N. Jones, “The Social Impacts of Trade Liberalization: How Can Childhood Poverty Be Reduced?” *Young Lives Policy Brief 1* (2005) <<http://www.younglives.org.uk/>>.

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