Trade Liberalization: Is It Desirable for All Developing Economies?: A Literature Review

Mehmet Huseyin Bilgin[1]

[1] Istanbul Medeniyet University & Eurasia Business and Economics Society, Turkey

Correspondence: Mehmet Huseyin Bilgin, Istanbul Medeniyet University & Eurasia Business and Economics Society, Turkey.

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Abstract

Economic theory says all countries benefit from free international trade. However, does this belief tell the whole story? Can all countries indeed benefit from free trade? For instance, is it any good for developing countries? In the literature, there are many studies and some of them present ideas against free trade. In this paper, we strive to provide a brief of the literature on developing economies.

Keywords: international trade, developing economies, literature review

1. Introduction

In the economic theory, it is believed that trading typically makes a country better off. This argument explains why countries trade with each other. It is argued that citizens of every country can enjoy and benefit from free trade as a consequence of the competition that occurs in international trade. As a consequence of free trade, a greater variety of products can be obtained, usually at lower prices. Therefore, international trade increases productivity and income through specialization. That is what the classical international trade theory states. Hence, all countries should open their borders and encourage free trade. This is the second-best choice for countries.

However, it is questioned if free trade is profitable for all countries. Can all countries benefit from the free trade at least at the same level? A fundamental principle of economics - comparative advantage - says free trade is good for all countries. According to this approach, countries benefit from free trade because of their comparative advantages. In his “Basic Economics”, Sowell (2007) asserts that citizens of all countries profit from free trade through comparative advantage.

As Murtala et al. (2017) argue, after the Second World War, world trade has been growing continuously due to numerous factors. There is a consensus that the global trading system has become more open after the 1980s’ in globalization period, especially after WTO (World Trade Organization) meetings in Doha in 2001. Greenaway et al. (1997) mention the 1980s and 1990s have seen a remarkable wave of unilateral liberalization. In fact, as Mazumder (2008) suggests, the liberalization of trade restrictions and the advent of WTO in recent times have expanded the trade between countries.

Another paper (Dean, 1995) studies the dramatic shift from protectionism toward free trade in the 1980s. During the 1980s, increasing numbers of developing countries liberalized their trade regimes (Dean, 1995). The main reason behind the liberalization story of developing countries was to take full advantage of the opportunities for development through trade. In this framework, South Asia, Latin America, and East Asia have implemented extensive reforms, yet each region has shown a distinct difference in approach and the degree of liberalization achieved. Dean (1995) argues Latin America stands out as moving sharply toward the level of openness of the East Asian Newly Industrialized Countries. However, there is little progress toward free trade in Africa. As a result, over the past 20 years, the growth of world trade has averaged 6 percent per year, twice as fast as the world output.

Despite two decades of trade liberalization, the level of the tariffs remains at a high level in many countries; most countries also have imposed some non-tariff barriers. Besides, trade barriers in industrial countries are concentrated in the agricultural and labor-intensive sectors in which developing countries have a comparative advantage. The developing countries' economies are characterized by heavy dependence on agriculture and labor-intensive sectors. Additionally, developing countries impose tariffs on imports from each other that are as high as those they impose on imports from developed countries. Another point is that the protectionism in international trade and trade wars (sometimes through exchange rates wars) have been growing more popular in the recent years where the USA has been the leader of this new era. As Gnangnon (2018) argues, the world has experienced a backlash against free trade over the last years. This period can be described as the rising of the protectionism.

In the sum, as the theory says and the outcomes of many studies show, the trade openness has positive effects of the economic growth of the country that is open for international trade. By contrast, in many countries, especially in developing economies, there are some parts of the society (sometimes including political parties, governments, businessmen associations, labor union, etc.) are against the trade openness and free trade. In fact, Spilker et al. (2018) ask what kinds of trade liberalization agreements people in developing countries want? In their paper, the authors examine individual trade policy preferences with regard to PTAs (preferential trade agreements) that can vary in content along several dimensions. Here, the effects of free trade in developing countries are the main issue. Therefore, in this paper, we seek to provide a brief of literature on the effects of international trade in developing economies.

In the last decades, some literature surveys have been done. For instance, Winters (2004) surveys the recent literature on trade liberalization and economic growth. The most plausible conclusion of this survey is that liberalization generally induces a temporary (but possibly long−lived) increase in growth. Moreover, Murtala et al. (2017) examine the viable impact of scholarly research on trade liberalization by a bibliometric approach from 1980-2015. In their paper, they analyze 886 academic articles extracted from the ISI Web of Science Core Collection database. Additionally, Hillman (2003) presents a survey of the literature on trade liberalization and globalization.

However, our paper focuses on studies that have been done for developing economies. This paper is organized as follows. Section 2 presents a brief of literature on the effects of international trade in developing economies. Section 3 concludes the paper.

2. Literature Review

In the literature, many papers analyze the effects of international trade on the main economic indicators. In this regard, the relation between trade openness and economic growth is one of the most popular issues. The results of most of those studies say free trade (or greater trade) has positive effects on growth. For instance, Manni and Ibne Afzal (2012) indicate that GDP growth increased consequent to liberalization. Also, their quantitative analysis suggests that greater openness has had a favorable effect on economic development. Both real exports and imports have increased with greater openness.

In this framework, Irwin (2019) focuses on the impacts of the trade reforms on economic growth and asks if trade reforms that significantly reduce import barriers promote economic growth. His results show that trade reforms that significantly reduce import tariffs have a positive impact on economic growth. Moreover, Gnangnon (2018) examines the impact of multilateral trade liberalization on the economic growth rate by using an unbalanced panel dataset comprising 150 countries over the period 1995-2015. The results of the paper suggest a strong positive impact of multilateral trade liberalization on economic growth.

Some analyses in the literature focus on developed and developing economies. For example, Leibovici and Crews (2018) investigate the extent to which trade liberalization affects developed and developing countries differently. The authors examine whether exports respond differently to changes in trade barriers in rich and poor countries. Moreover, Francois et al. (2003) explore the possible economic effects of the new WTO Doha Round of trade negotiations for major developed and developing regions. In addition to these studies, Ghani (2009) shows that the impact on the merchandise trade balances differs between the two groups of trading partners (developing countries and industrial countries). Furthermore, another study (Greenaway et al., 1997) concentrates on a group of countries which have liberalized in the post-1985 period and focuses on the effects of liberalization on the growth of GDP.

Nevertheless, most of those studies have analyzed this relation to developing economies. Some authors argue that the benefit of comparative advantage is also important for developing economies. For instance, Edwards (1993) argues that countries become more open and liberalize their trade regime, grow faster, especially developing economies. Moreover, Utkulu and Ozdemir (2004) investigate the effects of trade liberalization on long-run income per capita and economic growth in Turkey. Their findings show a positive correlation between trade liberalization and economic growth. Additionally, Bojanic (2012) investigates the relationship of economic growth with financial development and trade openness for Bolivia during the 1940-2010 period. According to the empirical results, there is indeed a long-run equilibrium relationship and the causality runs from the indicators of financial development and trade openness to economic growth.

On the other hand, Sheldon et al. (2018) examine the trade liberalization and constraints on moves to protectionism and focus on the multilateralism and regionalism. In particular, Mazumder (2008) traces the impact of liberalization of trade on developing countries. Abbas (2014) investigates the impact of trade liberalization on the economic growth of selected developing and least developed economies by augmenting standard production function. Dornbusch (1992) reviews the actual situation of protection in developing countries and then discusses the prospective gains from liberalization. Gnangnon (2019) examines the impact of multilateral trade policy on developing countries' economic exposure to shocks. In the paper, a panel data set comprising 120 countries over the period 1996-2013 is used. The author argues that multilateral trade liberalization has a negative and significant impact on economic exposure to shocks.

Ghani (2009) examines the impact of trade liberalization on the merchandise trade balance for a sample of developing countries that have adopted trade liberalization policies. Another paper (Whalley, 1989) documents recent external sector liberalization in developing countries. The paper concludes by suggesting that, in the short to medium term, some reciprocal actions by the developed countries in the liberalization would help to keep domestic political support for these liberalizations alive.

Furthermore, Santos-Paulino (2002) examines the impact of trade liberalization on export growth for a sample of developing economies. The main finding of the paper is that trade liberalization is a significant determinant in export performance, but its effect varies across continents. Additionally, Osakwe et al. (2018) explore the relationship between trade, trade liberalization, and exports diversification in developing and Sub-Saharan African countries. The results indicate that developing countries that are more open to trade (based on trade intensity) tend to have more diversified exports structures than those that are classified as less open. By contrast, for Sub-Saharan African countries, countries that are more open to trade have less diversified exports structures. Hence, trade liberalization (lower tariffs) contributes to exports diversification in developing countries, and the results for the long term are even stronger for Sub-Saharan African countries. The results also show that human capital, GDP per capita and institutions, play important roles in exports diversification.

Another paper (Nabli, 1990) addresses the issue of trade liberalization in developing countries from a political economy perspective using the theory of collective action. In the paper, a sample of 51 liberalization episodes relating to 24 countries and spanning the period 1950-80 is used. The author found five factors to be critical in the process of liberalization. However, as Weisbrot and Baker (2002) argue, there are costs associated with trade liberalization for the developing countries. When the benefits and costs of continued liberalization along the lines set out in these agreements are evaluated according to standard economic research, it is not clear if the developing countries as a group are facing a net gain.

On the other hand, Lee (2005) analyzes both multi-country and country studies on the impact of trade liberalization on growth and employment in developing countries. In another paper, Lee (2017) investigates the link between trade liberalization and the job-matching process in India by estimating an aggregate matching function by incorporating trade openness as a proxy for trade liberalization. The results of Lee (2017) show that trade liberalization leads to a decline in the number of new hires.

In their paper, Winters and Martuscelli (2014) present key recent literature on the effects of trade liberalization on poverty in developing countries. The authors mention that the fact that liberalization generally boosts income and thus reduces poverty has not changed; some authors suggest that this finding is not true for extremely poor countries, but this suggestion is far from being proven at present. A fairly common finding is that female workers gain from trade liberalization. Additionally, Vivarelli and Meschi (2009) use a dynamic specification to estimate the impact of trade on within-country income inequality in a sample of 65 developing countries over the 1980-99 period. Their conclusions show that trade with high-income countries worsens income distribution in developing countries, through both imports and exports.

From a different perspective, Mathew and de Cordoba (2009) attempt to answer if trade liberalization in environmental goods helps developing countries. Moreover, some studies in the literature investigate the effects of international trade on different sectors. For example, Shafaeddin (2005) analyzes the economic performance of a sample of developing countries that have undertaken trade liberalization and structural reforms since the early 1980s with the objective of expansion of exports and diversification in favor of manufacturing sector. The findings of this paper are varied for different country groups.

On the other hand, Chikhuri (2014) investigates the agricultural sector role in the African economic development process. The author uses panel data analysis to examine the long-run structural relationships between agricultural trade liberalization and economic growth. The results of the paper support the claim that agricultural growth through trade liberalization is a major determinant in economic growth in Sub-Saharan Africa. Additionally, Chikhuri (2013) investigates the linkage between agricultural trade liberalization and food security in Sub-Saharan Africa. The outcomes of alternative trade liberalization strategies on key food security indicators are ambiguous. The impact varies depending on the extent of liberalization and also the comparative advantage of the countries at the sectoral level.

Furthermore, Crivelli (2016) empirically tests whether and to what extent the domestic tax revenue has compensated for the trade tax revenue lost by looking at the experience in a panel of 33 transition countries in Eastern Europe, the former Soviet Union, and North Africa and the Middle East. The paper finds evidence of strong revenue replacement for total domestic tax revenue. The paper also provides some empirical evidence suggesting that replacement may have been higher for countries in the run-up to the EU and that countries with a high tax revenue effort may have relied relatively more on the PIT to replace trade taxes. In fact, as Mukherjee and Haque (2009) mention, recovering revenue loss due to the reduction in import tariffs is a major concern of many developing economies.

There are also some studies which focus on a specific country case. For instance, Rasoulinezhad (2018) analyzes the effects of Russia’s WTO accession on Russia’s foreign trade policy with top 40 trading partners. The author uses a panel data estimation based on a gravity model for bilateral trade patterns in agricultural and industrial commodities between Russia and 40 trading partners during two separate periods: 2000-2011 and 2012-2015. Results of the paper show that economic size and trade remoteness show a great impact on the agricultural trade flows both before and after WTO accession of Russia, while the bilateral exchange rate has relatively stronger effect before the WTO accession and trade openness show a stronger impact after Russia’s accession to the WTO. On the other hand, economic size and trade remoteness affect the industrial trade flows positively both before and after the WTO accession, whereas bilateral exchange rate has a stronger effect before and trade openness shows a stronger impact after the accession.

In another paper, Ozcan (2018) investigates the impacts of information and communications technology on international trade between Turkey and its trading partners. In the paper, an extended panel gravity model framework is used and the paper examines the effects of four ICT indices on Turkish bilateral exports and imports with static and dynamic panel data models for the period 2000-2014. The results indicate that ICT has positive and significant impacts on both Turkish import and export volumes. Additionally, ICT has a quantitatively larger effect on imports than on exports. These results are robust to alternative model specifications and estimation methods. Based on these results, some policy implications can be derived. For instance, Turkey may develop strategic trading partnerships with countries that have achieved high levels of ICT development, in order to increase its overall trade.

Additionally, Tsen (2016) examines the impacts of exchange rate volatilities on real total export from Malaysia to the United States (US). The author recommends to the exporters of Malaysia to improve their products through innovation and high technology and to further diversify their exports to reduce the impact of exchange rate volatility. Manni and Ibne Afzal (2012) investigate the impact of trade liberalization on Bangladesh economy between the period of 1980-2010. Hamad et al. (2014) analyze the effect of trade liberalization on economic growth in Tanzania. The empirical findings indicate that trade openness had a positive and significant effect on economic growth in Tanzania. Another research (Mandal and Roy, 2018) addresses a small open economy comprising of three sectors: two formal sectors and one informal sector.

3. Conclusion

The international movement towards open markets prompted by the WTO has its premise that trade liberalization will benefit all those who are concerned (Murtala et al. 2017). Traditional trade theory says a country gains from international trade regardless of its size. In other words, every country will benefit from free trade through comparative advantages. Hence, each country will be able to exploit its position of comparative advantage, once a free and fair trade regime has been implemented.

This new era, of course, brings some new questions. Perhaps the most important one is if free trade is good for all countries, why some developed and developing countries impose certain measures against free trade? Why protectionism has been popular again? If the lower tariffs promise significant benefits to the developing countries, why are there opposite ideas against free trade in those countries?

Furthermore, most developing countries define their comparative advantage through the agriculture sector and this remains the most protected sector in developed countries during the liberalized period. Hence, we believe free trade does not tell the full story. As Devadoss (2006) argues, despite Doha Round, the global trade negotiations have collapsed. One of the main reasons for this is the unwillingness of the developed countries to reduce their enormous agriculture subsidies and massive agricultural trade distortions. Therefore, it could be concluded that developing economies cannot benefit as much as developed countries.

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