

Master PPD M1

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Lecture14 – Trade policies, openness and regional integration for developing economies

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Trade and macroeconomics

- ❑ Trade: not a macroeconomic issue for OECD countries?
 - ❑ Is trade conducive to growth in developing countries? To poverty reduction? Diverging views among economists.
 - ❑ Developing countries are specific. They were quite similar in the 60s. Now emerging countries and LICs differ widely.
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Developing economies: specificities

□ Trade asymmetry

- Export as a “quasi investment goods sector”

□ LICs

- Concentration of exports on a few commodities
 - Prices set on international markets
 - Volatility (commodities as financial assets)
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Outline

- **Theory**
 - Policies and institutions
 - Empirics
 - Regional economic integration
 - A New Approach
-

Mainstream: Ricardo/HOS

- ❑ Specialisation according to comparative advantages = gain for the country (static, but not for everybody in the country)
 - ❑ Stolper Samuelson: convergence of factor remunerations (increase of the remuneration of the most abundant, decrease of the less abundant factor)
 - ❑ May work also with increasing return to scale (static)
 - ❑ Models and experience show that the gains are limited
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Development economics before 1980: export pessimism+protectionism

- Prebisch-Singer hypothesis: the terms of trade between primary products and manufactured goods tend to deteriorate over time
 - or terms of trade between products exported by developing countries and products imported by those countries?
 - Bhagwati: Immiserizing growth (1958)
 - Unequal exchange (Emmanuel 1972): equalization of the rate of return to capital at the world level, real wages increasing in the North, stable in the South.
 - Protection (fiscal instrument as well)
 - Import substitution with (Korea) or without (Brazil) change in specialisation
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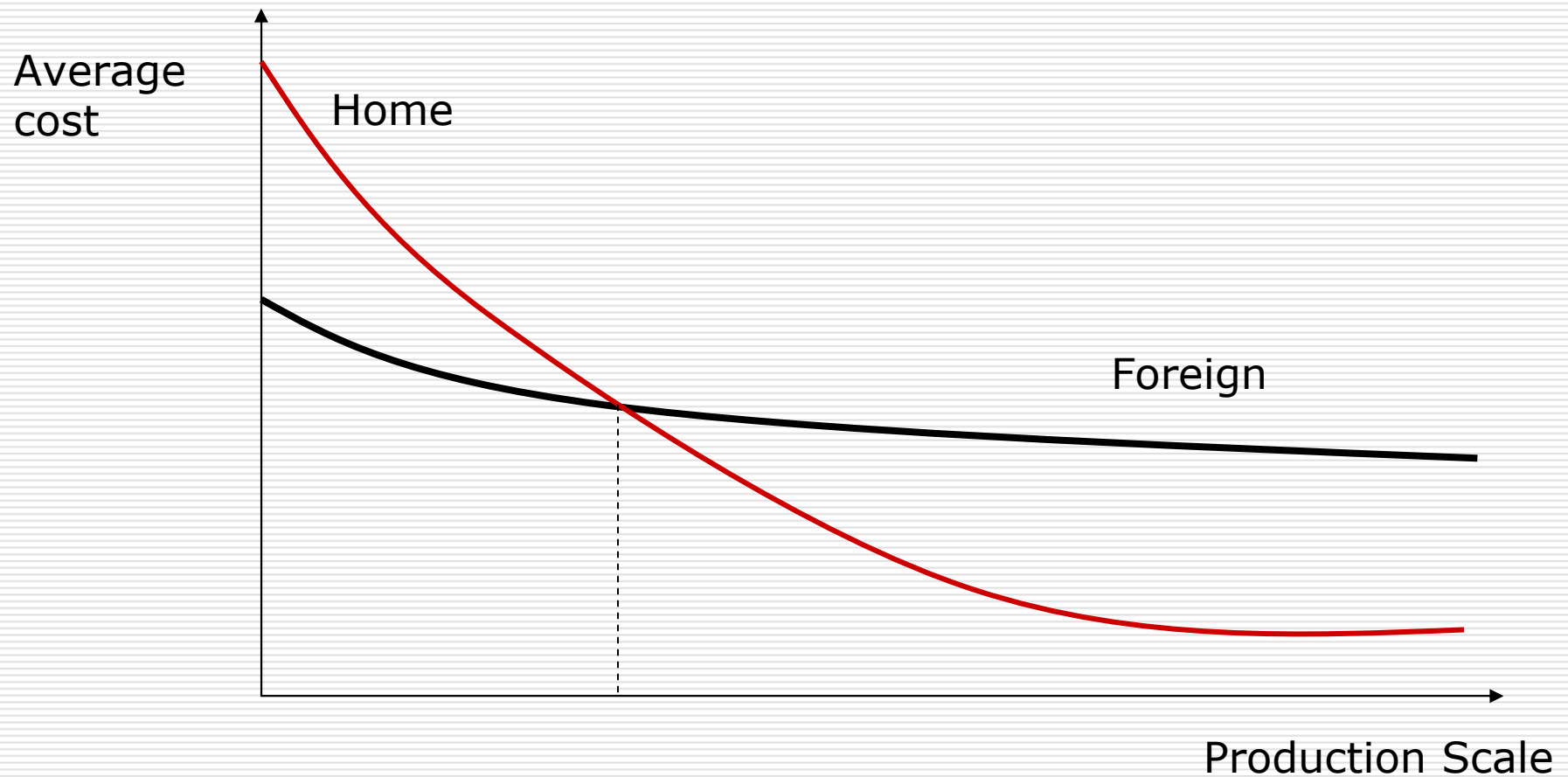
Further problems: when a blessing becomes a curse

- Dutch Disease: an sharp increase in the export income (oil, etc.) may result in:
 - Loss of competitiveness, decrease of traditional exports.
 - Shift of factors of production to the booming sector
 - Management of booms?
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Specialisation and endogenous growth theory

- Endogenous growth theory: policies may increase the income level, but may also impact the rate of growth of the economy
 - Specialization does not always increase growth and/or income.
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Strategic trade with imperfect competition (Dixit, Stiglitz)



A case for infant industry protection?

- In some cases, yes
 - But the size and the growth of the domestic market is crucial
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Policies and institutions : before the 80s

- ❑ Import substitution (mercantilism?) + “fair” prices for commodities
 - ❑ GATT: non reciprocity (1964), Generalized System of Preferences, STABEX (European export earnings stabilisation system: 1975-2000)
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Policies and institutions

- Structural adjustment:
 - Washington consensus: trade liberalization is crucial. Example: Asia
 - Focus on exchange rates (equilibrium exchange rates, devaluations)
 - Focus on distortions: effective rate of protection (added value of domestic production in dollar terms compared to the added value without tariffs in dollar terms)
 - WTO (1995): reciprocity, EU: economic partnership agreements (EPA)
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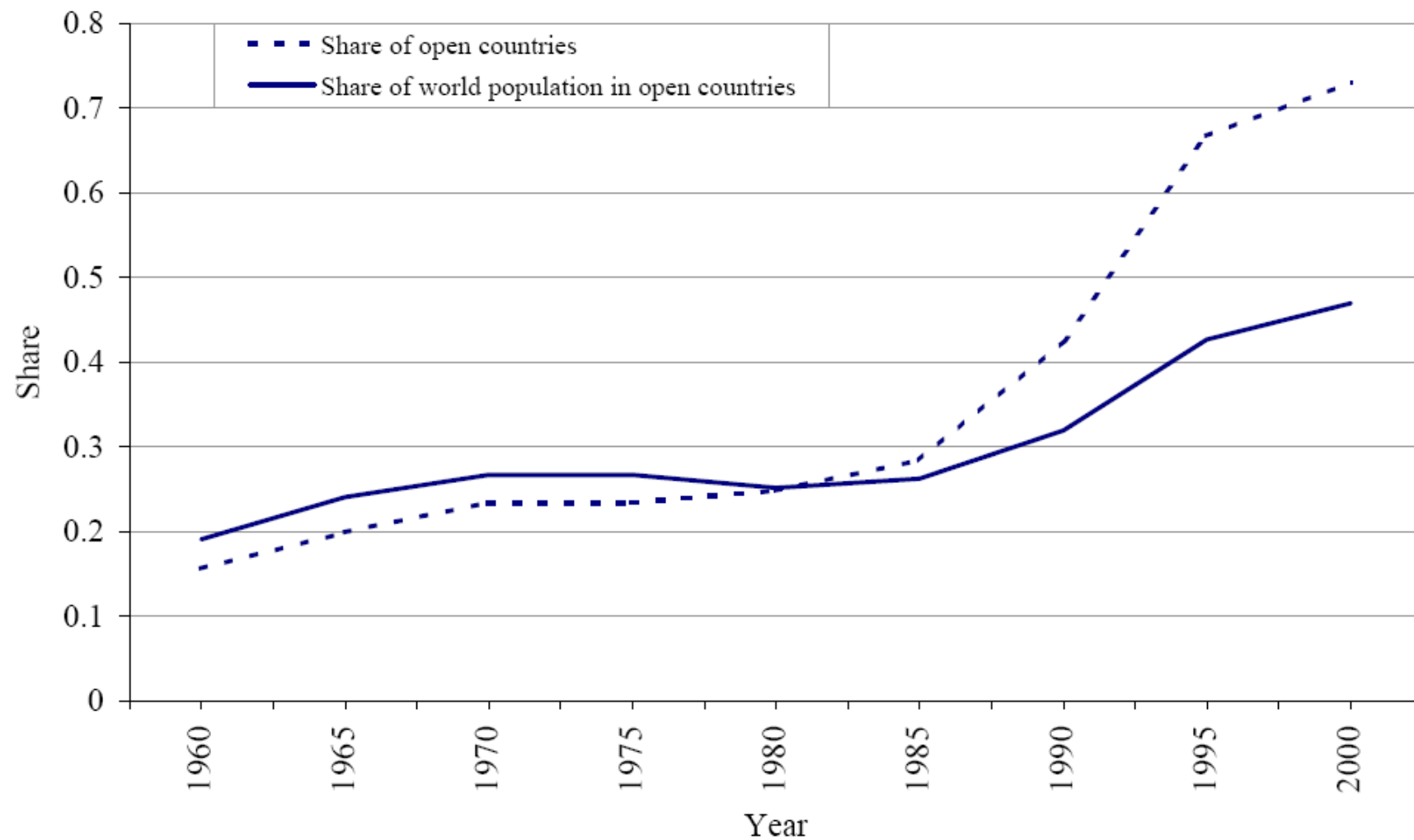
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- Theory
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 - **Cross-country**
 - Case studies
 - Regional economic integration
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Cross-country

- ❑ A growing numbers of countries experienced trade liberalization
 - ❑ What have been the impacts?
 - ❑ Most influential paper is Sachs & Warner (1995), widely discussed, namely later by Rodriguez and Rodrik (2000)
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Figure 1 - Openness in the World (Sachs and Warner Criteria) - 141 countries.



Openness and growth: empirics

- Sachs and Warner (1995): Openness (not trade) is conducive to growth: the estimated effect of the dummy variable for openness in regressions explaining 1970-1989 growth was very large (on the order of two percentage points of annual growth or more)
 - According to S&W, a country is not “open” if one of those conditions hold (dummy variable):
 - Average tariff rates of 40% or more,
Nontariff barriers cover 40% or more of trade, Black market premium > 20 %, socialist, public monopoly on exports (marketing boards)
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Empirics: discussion of S&W

□ Measure of openness:

- = barriers to trade. Most important for S&W: black market premium, public monopolies.
 - Are likely to reflect broader problems: institutions, distortions, other policies (Rodriguez & Rodrik 2000). Why not only tariffs and non tariffs barriers?
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Empirics: discussion of S&W (con't)

□ Lack of robustness:

- S&W does not work in the 90s (Wacziarg & Welch 2003): in this decade, open countries do not grow faster, they do not converge.
 - But “Number of years of open economy” robust in the Xala-I-Martin 2 million regressions
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Openness and Poverty

- Dollar & Kraay (2004):
 - Impact of the change in openness ratio (trade to GDP):
 - Countries that liberalize experience higher growth (convergence)
 - No impact on inequality (Poorest 20%): positive impact on poverty.
 - Using the poorest 20% may be flawed (too much in the OECD countries, not enough in LICs)(Nye, Reddy & Watkins)
 - Behrman, Birdsall, and Székely (2003) found positive influences of trade liberalization on wage inequality
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Empirics

- Many econometric studies, rather unconvulsive.
 - Size matters. Trade openness measure should take into account the size of the economy, distance to partners countries (gravitational models)
 - Specialisation matters
 - Growth of international trade, growth in partner countries matter
 - Other policies matter (namely infrastructures)
 - Institution matter
 - Rigidities matter (Freund & Bolaky JDE 2008, using « Doing Business ») (See next slide)
 - No clear assessment on what are the transmission mechanisms between trade and growth (reduction of rent-seeking, self discovery, openness to ideas,..)
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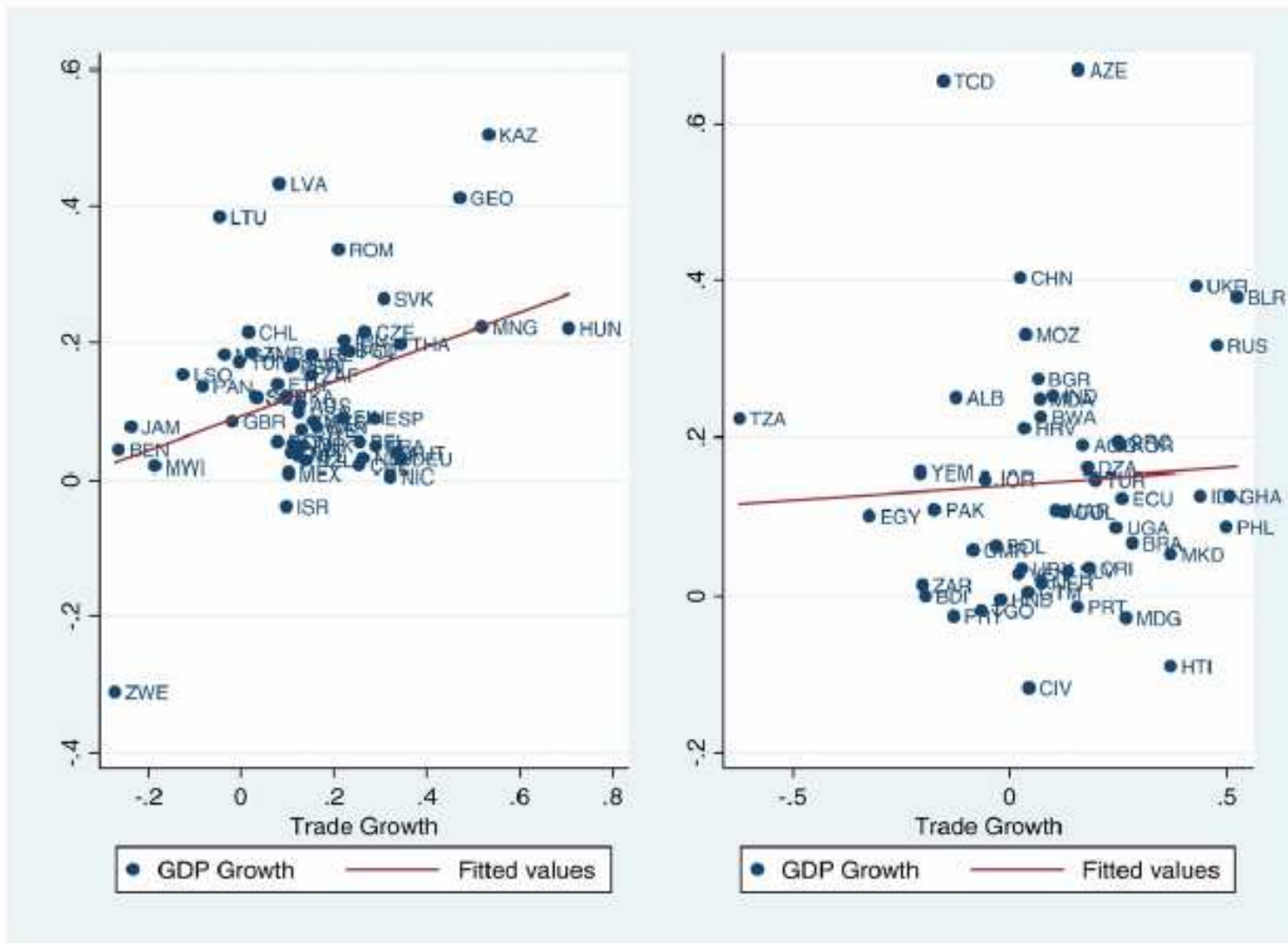


Fig. 2. The correlation between trade growth (1995–00) and income growth (2000–05) in least and most regulated countries. The left panel shows lagged trade growth and income growth in the 50% least regulated countries (regulation index at or below the median). The right panel shows lagged trade growth and income growth in the 50% most regulated countries (above the median regulation index). The measure of entry regulation determines the cutoff.

Source: Freund & Bolaky JDE 2008

Wacziarg & Welch (2003)

- Show a relationship between trade liberalization date and growth (1.5 % without fixed effects, .56 % with fixed effects). Mainly because after trade liberalization, **investment** increases (and trade too! –but not in the 90s) in the ten years following the trade liberalization.
 - Nevertheless, W&W point out that:
 - There is a vast amount of **heterogeneity** across countries in the extent to which growth rose after trade reforms. “Roughly half of the countries experienced zero or even negative changes in growth post-liberalization”.
 - “Generalizations about the **factors that may explain these differences** are difficult to draw. The preexisting institutional environment of countries, the extent of political turmoil, the scope and depth of economic reforms, and the characteristics of concurrent macroeconomic policies all seem to have a role to play”
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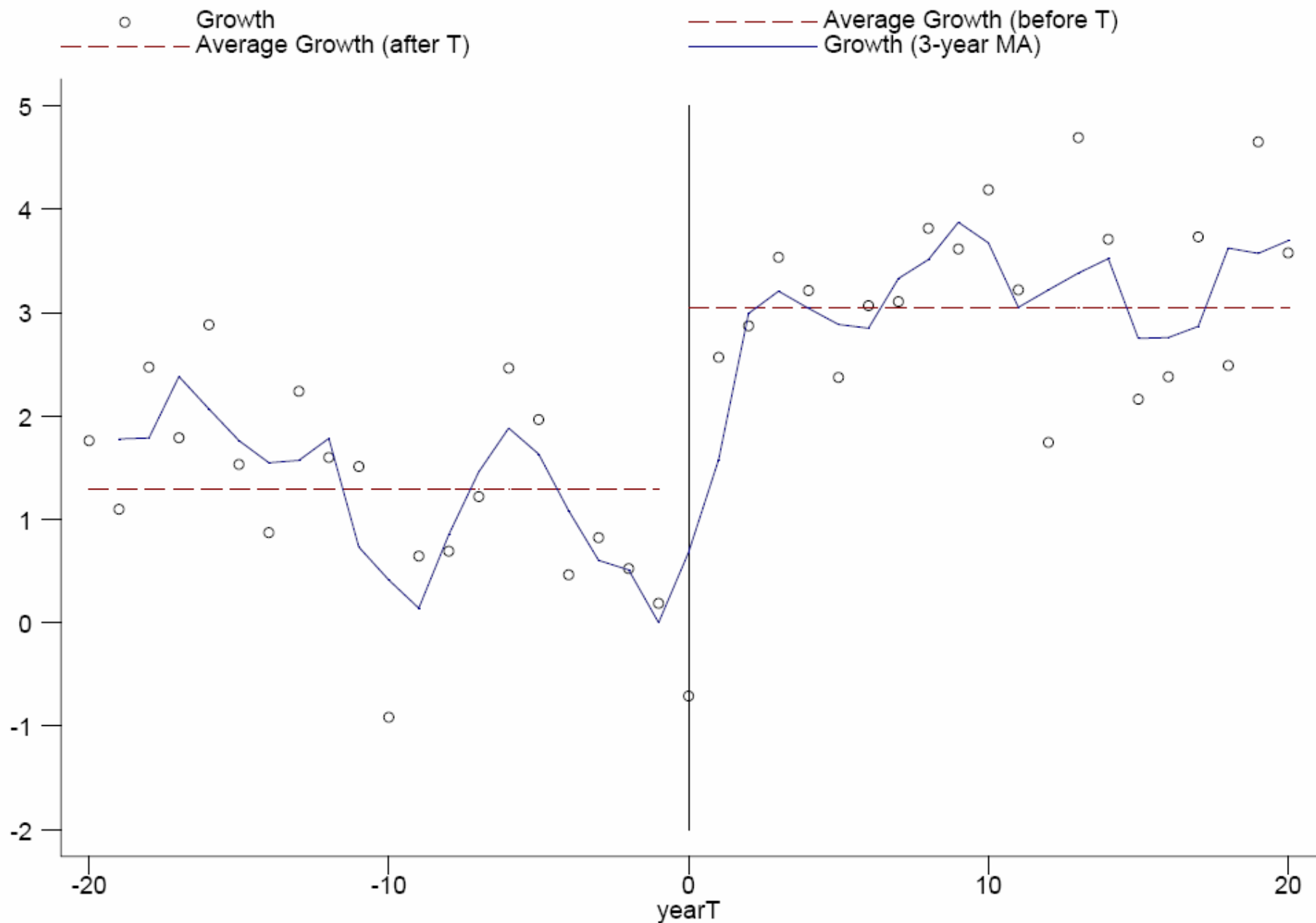


Figure 2. Growth and Liberalization - Sample Means

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Asian Miracle

- Insertion in the world market
 - But :
 - No big bang
 - unorthodox selective protection
 - State intervention to drive the upgrading process (selective credit, subsidies, wage repression) with crossed accountability.
 - Dynamic vs static comparative advantages (flexibility)
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Structural adjustment

- ❑ Rapid trade liberalization resulted in a short term (?) contraction: de-industrialisation, informalization
 - ❑ Failure of diversification of exports for LICs: devaluation can not achieve this.
 - ❑ Acknowledged by BWI (Zagha report, Spence report)
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Difficulties to access the world market: A case for regional free trade agreements?

- ❑ Huge number of regional free trade zones and economic unions among developing countries.
 - ❑ Increasing number of Free trade zone between some OECD countries and some developing ones (NAFTA, UE EPA, AGOA).
 - ❑ Theory:
 - Only general free trade is likely to be optimal
 - A risk of trade diversion (trade is diverted from a more efficient exporter towards a less efficient one) (Jacob Viner)
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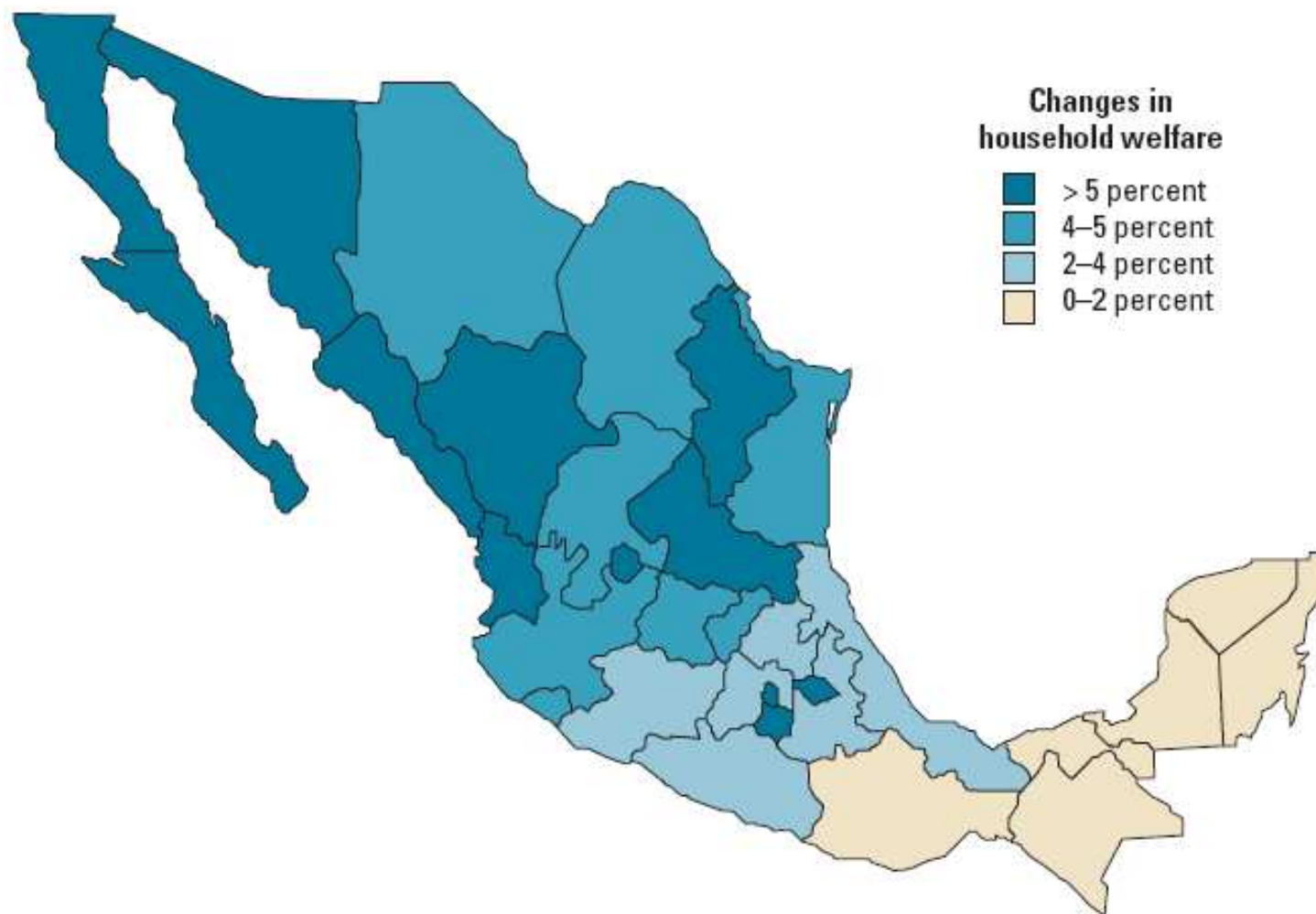
Difficulties to access the world market: A case for regional free trade agreements?

- ❑ Problem of specialisation: does it make sense to promote free trade among commodity exporters?
 - ❑ Problem of polarisation (concentration): Krugman on Geography and economic theory
 - ❑ Result: very low dynamism of FTZ in Africa (decreasing shares of the world market)
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Example: NAFTA (1994)(Assessment (D. Ramirez M.D., QREF 2003)

- ❑ Hard to disentangle the effects of NAFTA from the other non-NAFTA factors such as demand in the U.S
 - ❑ Under NAFTA Mexican trade and foreign direct investment inflows have risen at rapid rates, particularly in the export-oriented assembly-line sector (Maquiladoras) (but today competition with China!)
 - ❑ employment growth, real wages in manufacturing, and productivity performance: the record has been lackluster at best and disastrous at worst.
 - ❑ Manufacturing employment fell dramatically after the peso crisis, and remains stagnant. Real wages have plunged since the peso crisis and have yet to recover levels attained in the mid-1980s.
 - ❑ In terms of productivity performance, at best, the data show that productivity rose at healthy rates in the tradeable sector, but stagnated in the non-tradeable sector.
 - ❑ The distribution of income have become more skewed during the period of trade and investment liberalization
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Figure 9.4 It's better for household welfare to be close to economic opportunities



Source: Nicita (2004).

Note: Welfare changes were calculated from the effects of trade liberalization-related price changes that affected both the purchasing power and incomes of households.

Source: World Development Report 2006

New Approach (Rodrik, Siglitz)

- Trade liberalization has a good impact on investment and growth but linked with other policies (promoting investment, Rodrik 1999)
 - Trade liberalization may have adverse effects in the short run
 - Adjustment costs: depend on the labour market (Agénor & Montiel)
 - Transaction costs (Stiglitz & Charlton), for instance for complying with norms
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New Approach (Rodrik, Siglitz)

- ❑ Openness is an opportunity, not a development policy
 - ❑ Openness should be cautious (Spence report, Growth commission).
 - ❑ Openness should be country specific:
An assessment of what are the potential gains and what are the risks is needed.
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Rodrik on Spence report (2008)

- “Yes, successful economies have many things in common: they all engage in the global economy, maintain macroeconomic stability, stimulate saving and investment, provide market-oriented incentives, and are reasonably well governed. It is useful to keep an eye on these commonalities, because they frame the conduct of appropriate economic policies.”
 - “Saying that context matters does not mean that anything goes. But there is no universal rulebook; different countries achieve these ends differently.”
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References

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