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THE BENEFITS OF TRADE LIBERALIZATION AND ITS CONTRIBUTION TO ECONOMIC GROWTH

Abstract

Nowadays trade liberalization is the most popular economic policy of developed and developing countries. Usually, high and sustainable economic growth, combined with a greater opening of international trade is the main goal of economic policy in almost every country regardless of its degree of development. Therefore the paper perceive existing benefits of trade liberalization and its effects on economic growth in the world and particularly in a developing country like China.

The paper concludes that trade liberalization promotes economic growth and produces a number of potential benefits (efficient use of resources, encourage competition, facilitating and increasing the flow of ideas, knowledge and technology, etc.) through a number of channels. Trade liberalization significantly encourages foreign trade and cross-border financial flows, a greater volume of output and specialization, which ultimately leads to higher economic growth. The paper also indicates that most of the effects of trade liberalization are positive, but that they are influenced by many individual factors of each country and its other macroeconomic policies and conditions.

Key words: trade liberalization, economic growth, foreign trade, FDI, world output

JEL classification: F13, F30, F43, F21

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Introduction

Historical development of foreign trade policies in a global economy is characterized by two trends: liberalism and protectionism. These two types of policies are typical for certain periods of development of particular countries. They formulate them depending on the objectives that they want to achieve and the specific conditions in the international economic and political system.

In spite of different choice of foreign trade policies in the countries, in this process throughout history are noticed two features. First, the protectionism is characterized for the early stages of industrialization, and was present in both developed (XIX century) and developing countries¹ (the period after the Second World War). Second, over the last thirty years have seen a strong trend of leaving the rigid protectionism and increasing liberalization of foreign trade policies of most countries in the world.² Policymakers and scientists in that period, began to discuss the benefit of liberalization and outward-oriented policies, explaining that open policies increasingly contribute to accelerated growth, then inward-oriented or closed protectionist policies.

After the Second World War are made continuous efforts to liberalize world trade. The first negotiations were made under the General Agreement on Tariffs and Trade (GATT). From 1947 onwards, eight, often difficult, negotiation rounds resulted in gradual reduction tariffs. Seventh, the Uruguay Round (1986-1994), expanded trade liberalization in new areas such as intellectual property rights, services, capital and agriculture. In addition, during this round it was agreed the creation of the World Trade Organization (WTO). While GATT is a set of trade rules, the WTO is an international organization that oversees global trade and promote its further liberalization. The negotiations in Doha³ are the first multilateral trade

¹ After the widespread adoption of policies of import substitution in the 1950s and 1960s, most developing countries since the early 1980s shifted towards more open trade policies. The reasons for this change are varied and include sluggish performance of the policies of import substitution (Kruger, 1997).

² Toseva, G., *Efekti od liberalizacijata na nadvoresno-trgovskata politika na Republika Makedonija*, doktorski trud, Ekonomski institut – Skopje, Skopje, 2011, p. 24

³ Doha Development Agenda initially covers 12 areas (agriculture, industrial products, services, intellectual property, investment, competition, government procurement, trade facilitation, anti-dumping, subsidies, regional trade agreements and trade and environment).

round since the WTO was established. It was lunched in Doha, Qatar, in November 2001 and has not yet been completed. Its main objective is to integrate developing countries into the world trading system. In the center of the negotiation are three issues: a) reduction of agricultural tariffs in EU, b) reduction of agricultural subsidies in the USA and c) improve access of industrial goods and services on the main developing countries' markets. All this confirms the growing orientation towards the liberalization of the international trading system.

Taking into account the intensive process of liberalization in recent decades, this paper will consider the benefits of liberalization and its contribution to higher economic growth in the world.

1. THE EFFECTS OF TRADE LIBERALIZATION ON ECONOMIC GROWTH

With the globalization of world economies, almost all countries in the world are actively involved in reducing trade barriers between their trading partners. The main goal of moving towards free trade is to achieve macroeconomic objectives of their economies and higher economic growth.

Despite numerous debate, economists largely agree that trade liberalization brings significant benefits for each county. It is expected that trade liberalization would promote economic growth through more efficient use of resources, encourage competition, and by increasing the flow of knowledge and ideas across national borders.

The notion that trade liberalization inevitably leads to export increasing, and hence to economic growth is accepted by all multilateral institutions, primarily the WTO and the World Bank, IMF, OECD etc. In the context of this consideration, the latest two decades, many developing countries liberalize their trade regimes. Moreover, some of these liberalizations are implemented voluntarily, while most of them are actually implemented at the request of most important financial institutions, primarily the World Bank and IMF. They directly connected their credit arrangements with the trade liberalization as one of the important conditions for obtaining loans. The main role of the WTO, as a global trade

regulator, is to provide as easy as possible and faster flow of goods and services across national borders and thus stimulate economic growth and facilitate economic development of countries and regions in the world. WTO achieves this through the formulation and implementation of several principles that are the base of multilateral trading system, and supporting the principle of liberalization. These are:⁴

- Trade without discrimination (Most-favoured-nation (MFN): treating other people equally and National treatment: Treating foreigners and locals equally).
- Freer trade: gradually, through negotiation.
- Predictability: through binding and transparency.
- Promoting fair competition.
- Encouraging development and economic reform.

These principles have certainly contributed to greater trade liberalization in the world.

In the field of liberalization the GATT and the WTO recorded impressive success. Although GATT was conceived as a temporary document⁵ with a limited field of action, yet his success during 47 years in promoting and providing the world trade liberalization is indisputable. Within the GATT, negotiations to reduce customs duties were held in eight successive rounds. Actually, the first five of these rounds were completely committed to reducing tariffs. The next three had a broader agenda, but negotiations on customs reduction remained an important item on the agenda of these rounds.

⁴ https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm, accessed on 28 July, 2016

⁵ On October 30, 1947 has been agreed the content and scope of the General Agreement on Tariffs and Trade (GATT) as a temporary document which is supposed to regulate international trade until the overcoming of the problems with the ratification of the Havana Charter and the establishment of the International Trade Organization. But the International Trade Organization and the Havana Charter never realized so that the "temporary" GATT remained in force as the only international instrument in trade until the end of the Uruguay Round of negotiations and the creation of the WTO in 1995.

Table 1. MFN tariff reduction of industrial countries for industrial products, excluding petroleum

Implementation Round covered period		Weighted tariff reduction of all duties
1948–63	First five GATT rounds (1947–62) ^a	–36
1968–72	Kennedy Round (1964–67) ^b	–37
1980–87	Tokyo Round (1973–1979) ^c	–33
1995–99	Uruguay Round (1986–94) ^d	–38

Source: http://www.wto.org/english/thewto_e/minist_e/min99_e/english/about_e/22fact_e.htm#tariffcuts, accessed on 15 July, 2016

Note:

- a. Tariff reductions for the first five trade rounds refer to US only.
- b. refers to four markets: US, Japan, EC(6), and UK.
- c. refers to eight markets: US, EU(9), Japan, Austria, Finland, Norway, Sweden, Switzerland.
- d. refers to eight markets: US, EU(12), Japan, Austria, Finland, Norway, Sweden, Switzerland

The data presented in Table 1 show that the eight rounds of trade negotiations in GATT have been very successful in reducing customs duties. In addition to the previous statement is the fact that in the late 1940s, the average tariff on industrial products imposed by developed countries was about 40 per cent ad valorem, and as a result of eight GATT rounds since the mid-1990s the average tariff on industrial products fell gradually to 3, 9 per cent ad valorem.⁶

In period of application of the GATT and through eight rounds is achieved not only significant liberalization, but also the expansion of international trade. The continued reductions in tariffs helped encourage very high rates of growth of world trade. That is shown in Table 2. In 1948, the world export of goods amounted to 58 billion dollars, and in

⁶ Van den Bossche Peter, *The Law and Policy of the World Trade Organization: Text, Cases and Materials*, Cambridge University Press, Aug 21, 2008, p. 409

Table 2. World trade and output, Selected Indicators, 1948-98

	1948	1950	1973	1990	1998	Average annual change			
						1948-73	1973-98	1948-98	1990-98
World merchandise exports									
Billion current \$	58	61	579	3,438	5,235	9.7	9.2	9.4	5.4
Billion constant 1990\$	304	376	1797	3,438	5,683	7.4	4.7	6.0	6.5
World output (Indices, 1990=100)									
Commodity output	17	19	65	100	116	5.5	2.4	3.9	1.9
Manufacturing output	11	13	60	100	117	7.1	2.7	4.9	2.0
GDP (Billion, 1990\$)	3,935	4,285	13,408	22,490	27,615	4.9	2.9	4.0	2.6
GDP per capita (1990\$)	1,591	1,700	3,420	4,217	4,623	2.9	0.4	2.2	-1.4
Exports of goods and services, to GDP, at constant 1987 prices	...	8.0	14.9	19.7	26.4

Source: http://www.wto.org/english/thewto_e/minist_e/min99_e/english/about_e/22fact_e.htm#tariffcu accessed on 15 July, 2016

This is confirmed by the fact that in this period commodity production registered growth of 3.9% annually, or 8 times more.

1998 it was increased to 5235 billion dollars. During that period world trade increased by 6%, or increased 18 times. Moreover, the dynamics of trade liberalization helped to ensure that trade growth continuously intensify production growth.

This is confirmed by the fact that in this period commodity production registered growth of 3, 9% annually, or 8 times more.

The share of global trade in goods and commercial services in the world's gross domestic product (GDP) is also a reliable measure of economic liberalization. In 1950, exports of goods and commercial services represented 8% of GDP, while in 1998, this share of exports in GDP is 26.4%.

Immediately after the international trade, foreign direct investment (FDI) is also an important aspect of economic globalization and liberalization. FDI inflows increased from 24 billion dollars in 1973 to 60 billion dollars in 1985 up to 645 billion dollars in 1998. That is, FDI inflows grew 27 times (or 14% per year) in the period between 1973 and 1998.⁷ These results largely due to the continuous improvement of the conditions for international trade, i.e. permanent evolution on multilateral trading system.

Despite the upward trend of international trade in the analyzed period, from the table can be seen a trend of increasing economic growth represented by GDP and GDP per capita in the world. It leads to the conclusion that the whole process of liberalization has a positive impact on growth in the world economy.

A number of other analyzes and evaluations indicate the positive contribution of liberalization on economic growth. Namely, the World Bank continues to support the view that trade liberalization encourages economic growth if are met other conditions - such as macroeconomic stability, good governance etc. It believes that the openness of markets could generate a further increase in growth of 1-1.5% annually.⁸

Another assessment is that of the OECD, according to which the economic benefits of the removal of remaining trade barriers will be considerable:

⁷ http://www.wto.org/english/thewto_e/minist_e/min99_e/english/about_e/22fact_e.htm#tariffcuts, accessed on 15 July, 2016

⁸ Spanu V., *Liberalization of the international trade and economic growth: implications for both developed and developing countries*, Harvard University, Cambridge, May, 2003, p. 13-14

- A 10% increase in trade is associated with a 4% rise in per capita income.
- «Open» climate for FDI can be expected to produce 0.75% increase in GDP per capita in the OECD area.
- Lower regulatory barriers to competition could result in a 2% to 3% increase in GDP per capita in the OECD.
- More efficient customs procedures could improve global welfare by \$ 100 billion.
- Full tariff liberalization in agricultural and industrial goods could boost global welfare for an additional 100 billion dollars.

In Europe also the reduction of trade barriers boosted economic performance: the EU's GDP is estimated to be almost 2 percent higher as a result of the creation of the single market. But the EU has much more to do in reducing barriers to trade with the rest of the world, especially in agriculture. Increased external openness is an integral part of the Lisbon agenda for promotion of economic reform within the EU.⁹

It is also important to add that despite the aforementioned analysis and estimates, the large number of empirical studies, regardless of advanced modern econometric techniques, show a positive relationship between trade liberalization and economic growth (Thomas et al. 1991; Joshi and Little, 1996; Helleiner, 1994; Bleaney, 1999; Ahmed, 2000).¹⁰

2. TRADE POLICY LIBERALIZATION AND ECONOMIC GROWTH – SUCCESS STORY OF CHINA

Although the impact of trade liberalization on export activity and economic growth is one of the most researched in recent decades, however, the existing experiences of countries, especially the developing countries that have implemented trade liberalization, are very different.

Certain Asian countries are perhaps the most spectacular example of economic success linked to export performance and trade liberalization. While other developing economies implemented a strategy of import-substitution industrialization and experienced relatively low rates

⁹ Dobre C., The relation between openness to trade and economic growth, 2008, p.241

¹⁰ Parikh A., Trade Liberalization, Growth, and Balance Of Payments in Developing Countries: An Econometric Study, The International Journal, Volume XX. No. 4, Winter 2006, p. 430

of economic growth, the East Asian “tigers”¹¹ have adopted more open trade policies and experienced staggering rates of economic growth. But in many cases the strategy for success was not based on full application of the principle of free trade.¹² While some of these countries were fully oriented towards free trade, others applied interventionist measures, such as South Korea. It is also concluded that there is no completely single East Asian model that can be applied to promoting economic growth. In that context, they were identified three policies that contributed to the success of these economies:

- Industrial policy which promoted the specific sectors in the economy in order to achieve strategic orientation of the industry as the main economic branch;
- Policy of state supervision of financial markets that reduce cost of capital and focuses on the direct lending of strategic sectors and
- Policy that promotes export and protecting the domestic industry at a certain time.

Generally it can be stated that there is no way in which any of these countries would grow faster if it was not applied in all cases the strategy for accelerated growth in exports.

When it comes to Asian countries, particularly interesting is the case of China, which after three decades of inward oriented trade has launched the so-called policy of “open doors” in 1978, and which is currently one of the top world exporters.¹³ Since then, its exports grow 15, 5% per year (on average), and the rate of GDP growth is around 10% (Figure 1).

¹¹ Group of countries consists of: South Korea, Singapore, Taiwan, Hong Kong.

¹² Obradovic S., *Uticaj integracije i liberalizacije na privredni rast – empiriska evidencija u korist integracija u EU*, Ekonomske teme br.1-2, Ekonomski fakultet, Nis, 2005, str. 155

¹³ UNCTAD, <http://knoema.com/pqaqfne/major-exporters>, accessed on 8 August, 2016

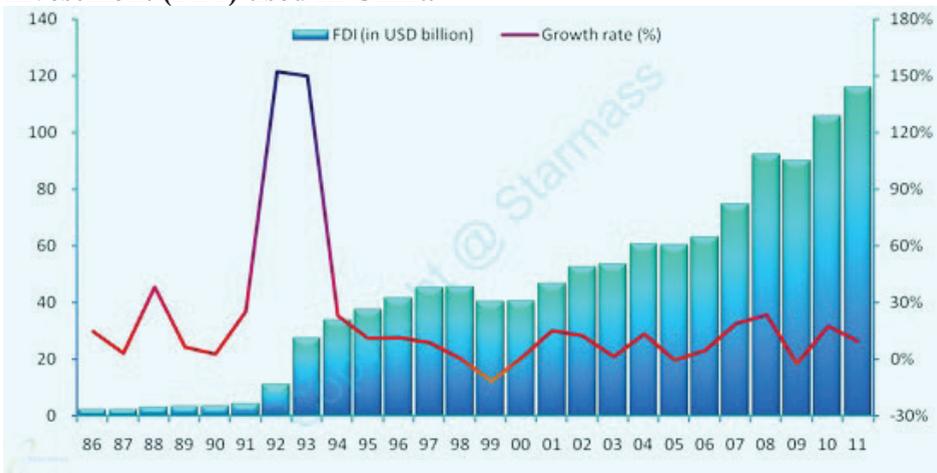
Figure 1. Annual average growth rate of export and GDP in China (1981-2014)



Source: Prepared by the author based on data from UNCTADStat

The driving force for this exceptional growth is the increasing openness of the economy, especially in trade and foreign direct investment. Actually, attracting FDI is pillar of the policy of opening to China. It is confirmed by the data about the volume and rate of growth of FDI in China that are shown in Figure 2. The role of FDI in promoting China's foreign trade focus on two aspects. First, the rapid increase in the volume of export and import of foreign investors has expand the scope of foreign trade of China. Second, FDI helped to upgrade the structure of export products of China.

Figure 2. Total amount and trends of foreign direct investment (FDI) used in China



Source: <http://www.starmass.com/china-review/foreign-investment/amount-FDI-used.htm>, accessed on 8 August, 2016

Foreign investors with their FDI in China introduced new technology, know-how, and international marketing opportunities and thus helped to change its comparative advantage. In the coming years, China will focus its investments in Research and Development centers, in new high-technology industries, advanced manufacturing and in sectors of energy saving and ecological adapted sectors. It is a classic example of export-oriented economic growth promoted by the government through the establishment of special economic zones and open cities, which are a magnet for investment. In all export-oriented economies, typical initiatives for exporters include: investment subsidies and allowances; exemption from taxes and duties on inputs for exported goods, favorable treatment of foreign investments, etc.

Conclusion

Generally, it can be concluded that trade liberalization promotes economic growth and produces a number of potential benefits (efficient

use of resources, encourage competition, facilitating and increasing the flow of ideas, knowledge and technology, etc.) realized through various channels. Trade liberalization leads to increased volume of trade and volume of output, encourages investment and greater specialization and technology transfer, and it certainly leads to greater economic growth.

The existing experiences of countries (especially the developing countries) about the impact of trade liberalization on export activity and economic growth are very different. Thus, China is an example of country with positive experience from the application of trade liberalization policy. After three decades of inward oriented trade it has launched the so-called policy of “open doors” in 1978, and it is currently one of the top world exporters. It has experienced significant progress not only in trade, but also in FDI. Attracting FDI is pillar of the policy of opening to China. The volume of export and import of foreign investors has expand the scope of foreign trade of China and FDI helped to upgrade the structure of export products of China.

Therefore it is important, each country in the implementation of trade liberalization to take into account its own characteristics - national legislation, foreign trade partners, export-oriented sectors, the share of primary exports in total exports, the rate of trade in GDP and how it is sensitive to foreign trade. Every country has the right to choose their own development priorities and its institutions and should be protected from external pressure.

It is also important to know that for the success of trade liberalization and its positive effects is not only important act of liberalization, but a wider range of economic policies and measures, and some other factors, such as natural and infrastructural barriers. In that regard trade liberalization is conditional in its impact on economic growth. In most cases economists highlight the need for a stable and non-discriminatory foreign exchange system, sound monetary and fiscal policies, corruption-free administration, the minimum required for trade liberalization in the long term.

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