



Trade Liberalization, Economic Growth and Development Strategies: Some Empirical Evidence and Lessons from Successful Asian Experiences

by

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DISCLAIMER

*The responsibility for opinions in this presentation rests with its author. It is based on two publications: the UNDP co-sponsored publication, “Making Global Trade Work for People” (Earthscan, 2003) of which Kamal Malhotra was lead author and coordinator, and “National Trade and Development Strategies: Suggested Policy Directions”, by Kamal Malhotra published in 2008 in Trade on Human Terms, Two Background Papers, Asia-Pacific Human Development Report 2006 (Human Development Report Unit, UNDP Regional Centre in Colombo). Publication, however, does not necessarily imply that the views expressed constitute policy of the United Nations Development Programme or the institutions of the United Nations system.



Linking Human Development and Trade

Trade can be a powerful source of economic growth. But while broadly based economic growth is necessary for human development, it is not enough.

Human development also requires enlarging people's choices and opportunities—especially poor people's.

Liberalizing trade does not ensure poverty reduction or human development, nor does it guarantee immediate economic growth. [Rather, this is largely determined by internal and external institutional and social pre-conditions.]

The nature of resource allocation and social inclusion — especially for women and those participating in the informal sector — are important determinants of growth leading to poverty reduction and human development.



Trade Liberalization and Growth

International trade can expand markets, facilitate competition and disseminate knowledge, creating opportunities for growth, poverty reduction and human development.

Trade can also raise productivity and increase exposure to new technologies, which often spurs growth.

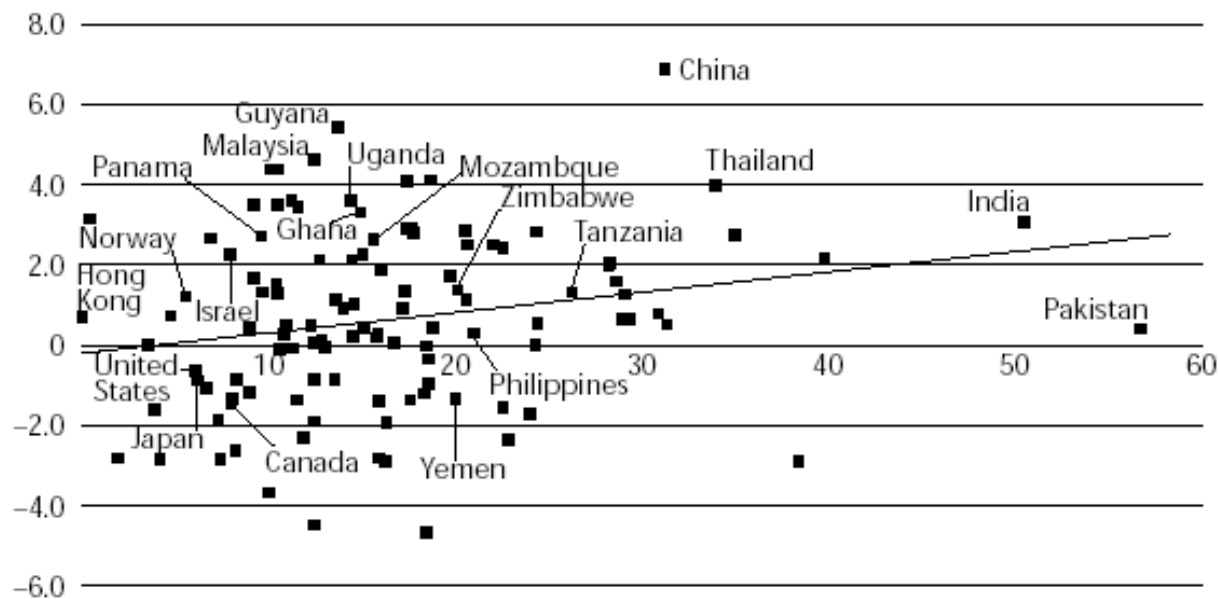
Nevertheless, cross-national comparisons reveal no systematic relationship between countries' average levels of tariffs and non-tariff barriers and their subsequent economic growth (see figure 1).



Figure 1

Low import tariffs are good for growth? Think again

Annual average per-capita GDP growth rate during the 1990s
(unexplained part, per cent) vs. average import tariff rate (per cent)

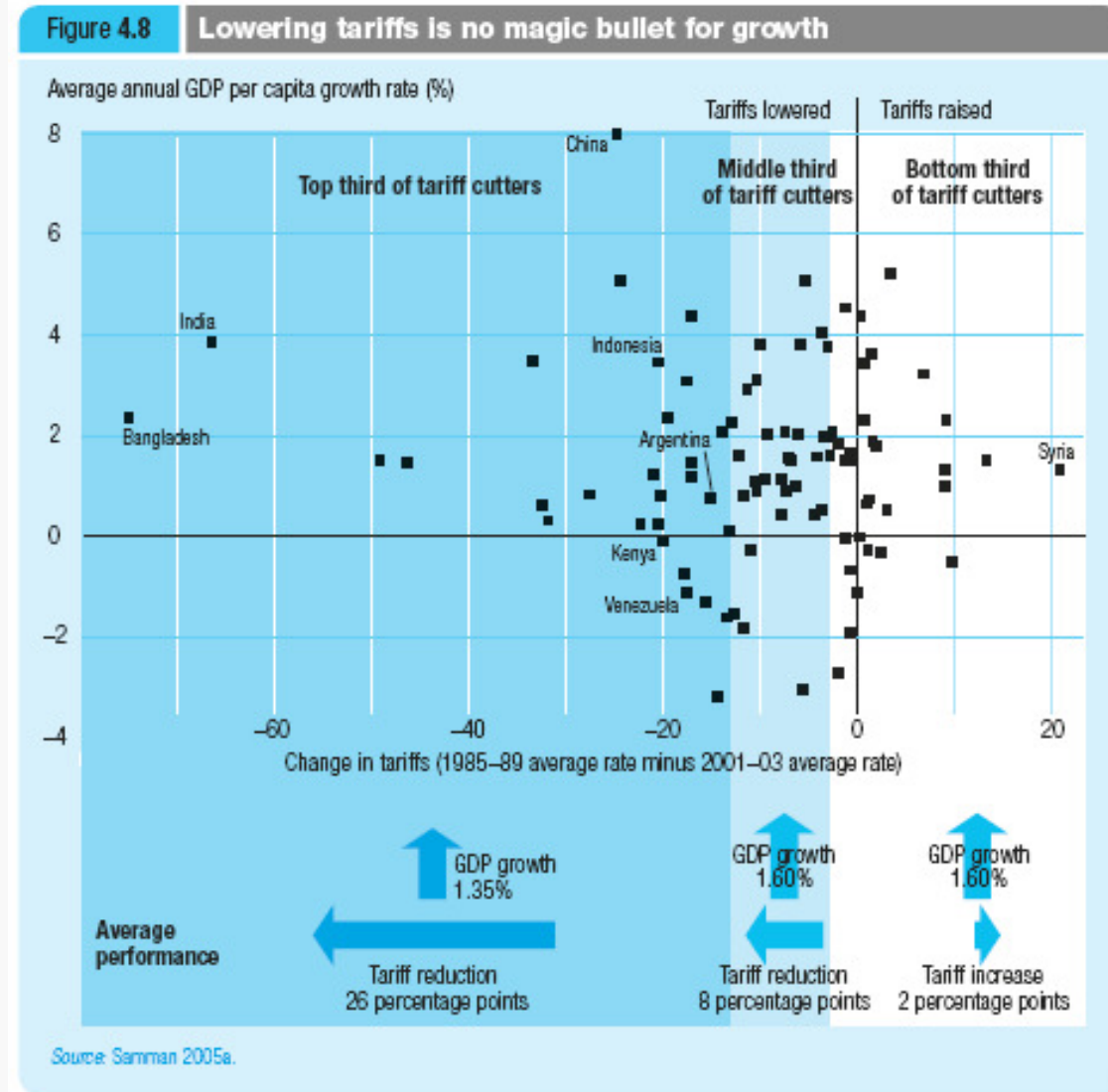


Note: All data are averages for the 1990s. Specifications are based on Dollar and Kraay (2000), replacing trade-GDP ratios with tariff levels and controlling separately for inflation, initial income and government consumption as a share of GDP.

Source: Dollar and Kraay, 2000, cited in Rodrik (2001).



Figure 2





Most recently in Asia, Viet Nam is a good example which illustrates that trade, especially import liberalization, is not a prerequisite for sustained economic growth (the Republic of Korea, PR China and India are others)

Since the mid-1980s Viet Nam, which only joined the WTO in January 2007, has taken a gradual approach to economic reform, following a two-track programme that has the following characteristics:

- ✦ Significant state trading
- ✦ Maintenance of important import monopolies
- ✦ Retention of quantitative restrictions and high tariffs (30-50%) on agricultural and industrial imports for much of the period since the mid-1980s till recently.



Yet Viet Nam:

- ✦ Achieved GDP growth of more than 6% per annum for a sustained period
- ✦ Sharply reduced poverty
- ✦ Expanded trade
- ✦ Attracted considerable foreign investment
- ✦ And (despite relatively high trade barriers for much of the period) is rapidly integrating with the global economy

All of this should not be seen as advocacy for high tariffs, but simply as a caution that simplistic correlations between tariffs and growth are likely to be misleading and the conventional wisdom/orthodoxy in this regard needs questioning!



Trade and Growth Literature

The best-known literature that claims trade liberalization promotes higher growth—including the Sachs-Warner (1995) and Dollar (1992) studies—are flawed in important respects.

The approaches used for classifying developing countries as 'open' or 'closed' have the following widespread problems:

- ✦ Policy outcomes such as trade as percent of GDP (which are often not in governments' control) are used as measures instead of actual trade policies (e.g. tariff reduction).
- ✦ Linked to the above, the measurements are based on rates of growth in trade volumes, which are the outcome of many things, including an economy's overall performance.
- ✦ Many such measures of openness are actually correlated with alternative explanatory variables such as: macroeconomic instability, poor institutions, and geographic location.



Once these problems are corrected, the only systematic relationship found is that countries dismantle trade barriers as they get richer.

The experiences of industrial and successful developing countries provide the following additional lessons:

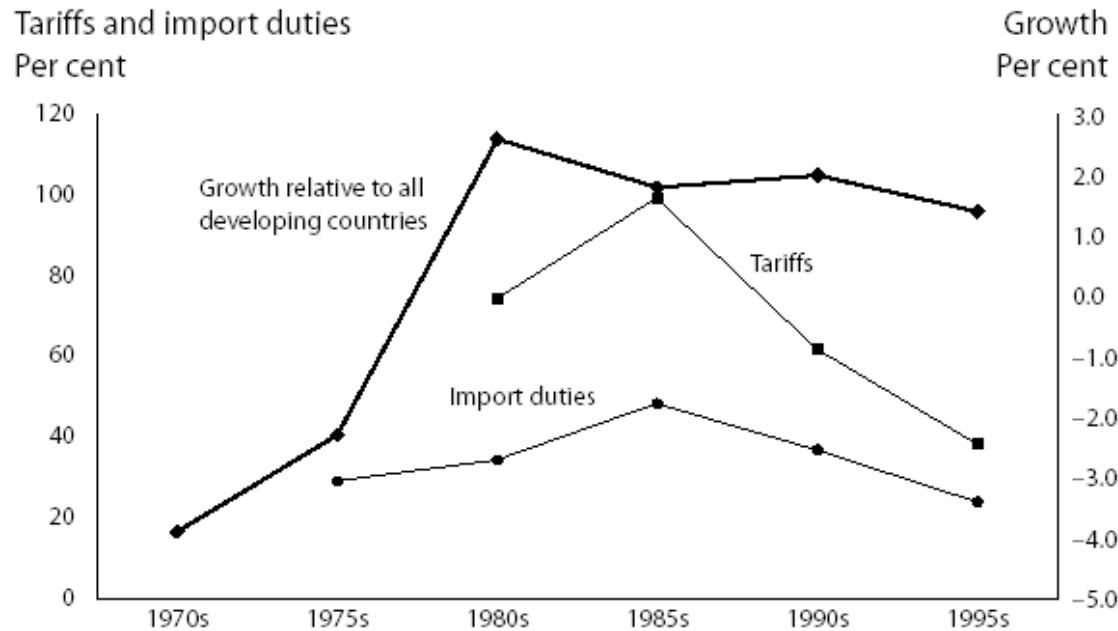
- ✦ Integration with the world economy is an outcome of growth and development, not a prerequisite.
- ✦ Institutional innovations — many of them unorthodox and requiring considerable domestic policy space and flexibility — have been crucial for successful development strategies and outcomes.



Figure 3

A rarely discussed fact is that both China and India implemented their main trade reforms about a decade after the onset of higher growth.

Tariffs did not impede growth in India



Source: Rodrik, 2001, using data in Dollar and Kraay, 2000 and World Bank, *World Development Indicators 2000, 2000*.



Experiences of China and India

Chinese and Indian trade restrictions were amongst the highest in the world at the same time as they had high sustained growth.

- ✦ China's economic growth rose in the late 70s. Yet, trade liberalization started only when the growth rate increased substantially - in the second half of the 80s and the 90s.
- ✦ India's growth rate increased substantially in the early 80s. Trade reform started during 1991 – 1993. Moreover, tariffs were higher in the high growth period of the 80s than in the low growth 1970s.



Experiences of China and India

It is therefore not obvious that:

- ✦ Further import tariff reduction is in all countries' interests.
- ✦ The world requires a set of global rules, universally applied, that promote greater freedom for global market actors

The Indian and Chinese experiences suggest that a gradual, sequenced approach is beneficial, and that import and trade liberalization are not necessarily the highest development priority, at least in the early reform period.



Experiences of the LDCs

LDCs have been told that trade liberalization reduces poverty, but their experiences have not proven this:

Poverty is increasing in the LDCs with both open and closed trade regimes. But between these extremes, poverty is increasing in countries that have liberalized trade more.

Conclusion 1: trade liberalization does not automatically or necessarily reduce poverty.

LDCs have also been told to export their way out of poverty. According to UNCTAD's LDC Report, GDP declined or stagnated in 8 out of 22 LDCs with increased exports. In 10 of these countries, poverty actually increased. But 14 with rising GDP saw poverty fall.

Conclusion 2: Unless there is sustained growth, increasing exports does not reduce poverty.



Experiences in East Asia: Their Growth Strategy

The Asian Tigers are often presented as examples of countries that predominantly relied on export-led growth. This was only one, and not necessarily the most important of their strategies. Other strategies used included:

- 1) Protection of the domestic market – most of their import liberalization occurred only after high growth was established in the 1980s
- 2) Government support to local investors through: credit subsidies; tax incentives, education promotion; generous export subsidies; duty-free excess to access and capital goods; extension of credit to large businesses at negative real interest rates. E.g. in the Republic of Korea, the state bailed out entrepreneurs investing in 'desirable' activities if these became non-viable.



Experiences in East Asia: Their Growth Strategy (cont.)

- 3) Public enterprises also enhanced the profitability of private investment by ensuring that key inputs were available for private producers eg. through a large share of manufacturing output
- 4) Encouraged firms to reverse engineer foreign-patented products
- 5) Imposed TRIMS requirements on foreign investors eg. export-import balance requirements; domestic content requirements.



Summary of Main Lessons

- 1) The only systematic relationship between countries' economic growth and their trade barriers is that they dismantle trade restrictions as they get richer. Economic integration is an outcome, not a prerequisite to growth and development.
- 2) Institutional innovations – many unorthodox and requiring policy space – are crucial for success.



Learning from Successful Asian Experiences

✦ **Simultaneous achievement of**

- 1) High economic growth rates
- 2) Significant poverty reduction
- 3) Human development advances

✦ **How?**

- 1) Varied mix of domestic investment approaches
- 2) Selective, purposeful and strategic global economic integration and effective management of globalization
- 3) Unconventional domestic interventions and institutional innovations



Key Ingredients of a Successful Policy Package

- ⊕ Public investment
- ⊕ Strategic national trade and industrial policies
- ⊕ Sectoral policies
- ⊕ Macroeconomic policies and trade
- ⊕ Strategic, selective and gradual liberalization
- ⊕ Correct sequencing of policies



1. Public Investment

✦ Human Development

- Simultaneous investment in education at ALL levels
- Education and Health as instruments of economic growth and of building competitiveness
- Good illustration of economic growth & Human Development as mutually reinforcing

✦ R&D and Technology Policy

- 21st century-New requirements of competition in a knowledge economy
- Adaptation of advanced technology and technological diffusion

✦ Infrastructure

- Trade related infrastructure (supply-side constraints)
- Aid-for-Trade, Trade Facilitation



2. Strategic National Trade and Industrial Policy

✦ **Infant Industry and Infant Economy Protection**

- Selective & time-bound infant industry promotion

✦ **Industrial Development**

- Successful industrialization: Moving up the ladder
- Selective protection, policy flexibility, cascading tariffs

✦ **Other Necessary Policies**

- Correcting for coordination failures
- Dealing with information externalities
- Domestic competition policy
- Export promotion



2. Strategic National Trade and Industrial Policy (cont.)

- ✦ **Exports and Technological Development and Employment**
 - Exports as one element of overall national investment policy
 - Strategic engagement with global markets
 - Export revenues used for productive investment & employment

- ✦ **Public-Private Partnerships: Need for strategic, balanced and flexible collaboration between national public and private sectors**
 - “Embedded autonomy”
 - Political leadership at highest government level
 - Competent government implementation agency
 - Effective coordination and monitoring
 - Transparency and accountability mechanisms



3. Sectoral Policies

✦ **Agriculture**

- Priority: Trade liberalization vs. Domestic livelihood and food security
- Policy space & Pro-poor investment

✦ **Services trade**

- Basic Social Services
 - Liberalization must be properly channeled to support development strategies
 - Premature privatization to be avoided
 - Need for adequate regulatory framework first



4. Macroeconomic Policies and Trade

✦ Exchange Rate Policy

- Exchange rate volatility is not conducive to the sustained growth of the trade sector
- Management of exchange rate is more important than using devaluation as an instrument of trade or appreciation to deal with reserve accumulation

✦ Monetary Policy

- Lower interest rates favored to choose a development-oriented policy
- Managed interested rate structure, differential interest rates and preemption and direction of credit



A Trade Regime Friendly to Human Development

A vision for the future: Four simple principles of international trade

- ✦ Trade is a means to an end, not an end in itself
- ✦ Trade rules have to allow for diversity in national institutions, development strategies and standards
- ✦ Countries should have the right to protect their own institutions and development priorities
- ✦ No country has the right to impose its institutional preferences on others.



Six Key Policy Messages

- 1) International trade : two-way virtuous relationship between human development and economic growth is possible
- 2) Raising the returns to investment through industrial and export policies is key
- 3) Both selective and general government interventions are needed to improve market outcomes. The question is not whether governments should intervene but “How”, “When” and “Where” to intervene



Six Key Policy Messages (cont.)

- 4) A key public policy intervention is simultaneously investing in all levels of education, including selectively and strategically in tertiary levels of education (institutes of science & technology, management, public health, education)
- 5) Building the state's capabilities to make effective public investment and selective interventions to stimulate a virtuous circle of economic growth, poverty reduction and human development should be a first order priority
- 6) There is a vital link between macroeconomic policies and trade competitiveness



Thank you

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