

## **Why is trade openness good for development? – Brussels, 3 April 2006**

Although political rhetoric and the popular press often retain a vision of the world where protection of domestic industry is a positive policy choice and openness to foreign trade a major risk to the economy, in fact no serious economist argues that trade protectionism is good for growth. The arguments are more about the most appropriate nature and sequencing of trade openness than on its desirability as such. There are compelling reasons why the belief that openness to trade is good for growth and development dominates economic thought:

**Openness to imports increases efficiency and reduces costs for industry.** Exposure to foreign competition forces domestic industry to become more efficient and competitive. It also aids this process by reducing the cost of key foreign inputs and enabling access to cost-saving and quality enhancing new technologies.

**Openness to imports reduces costs for consumers.** In the end it is almost always the consumers who pay the price of protectionism through lower quality goods and higher prices. Reducing trade barriers brings greater variety of products and quality, but also lower prices. This welfare effect for consumers is often the strongest element in the impact of liberalisation, particularly for highly protected industries, like agriculture and clothing.

**Trade openness entails restructuring costs** and incremental liberalisation is therefore often the only viable political and economic option. A higher level of competition on the domestic market brings efficiency gains and lowers prices but uncompetitive firms are likely to fail or downsize and this leads to job losses. As prices fall, consumer's purchasing power increases in a variety of sectors, leading to job creation. However this process of reallocation of workers takes time and is costly in the short term for the individuals concerned. Thus major overnight liberalisation is a politically difficult option.

**Reciprocal trade opening helps to deal with restructuring and political costs.** Within the context of a trade round, the restructuring costs of greater openness should be partly offset by the gains afforded by new market access opportunities. As a country's industry restructures and inefficient firms exit, efficient firms will grow and provide new jobs. Their growth would be facilitated by improved access to foreign markets. In addition, the negative impacts of restructuring are easier to sell politically if they are part of a multilateral effort where all actors are seen to face costs as well as opportunities. This is why there needs to be liberalisation by all actors to achieve a balanced solution in a trade round. Otherwise the costs of liberalisation are more difficult to offset, in developing and in developed economies.

Although the above arguments are based on theoretical linkages, **history gives us the most persuasive arguments for trade liberalisation.** Although it cannot be said that all developing countries that have opened their markets have automatically seen high growth rates, many have found that, in a sound domestic policy context, trade openness can be an important basis for economic growth. Furthermore, the fact is that no developing country has achieved sustained growth by putting up high trade barriers and limiting exports.

**It seems that trade openness is a necessary, but not a sufficient, requirement for development.** In other words openness alone can not ensure that a country develops, but without it, development is unlikely to occur. In fact the wider policy environment in developing countries (DCs) is a key factor, as are its resource endowments and the structure of its society in terms of equality and access to important factors like education.

**Overall, developing countries have benefited from the globalisation process** and we see that many have impressive growth rates based to some extent on rapidly growing trade.

In addition, they are moving away from the basic products and raw materials that had been the backbone of their trade into higher value added sectors which help to foster growth. The World Bank's analysis of globalisation growth and poverty found that DCs which are home to 3 bn people have broken into manufactured goods markets, which in turn has helped them to reduce poverty<sup>1</sup>. DCs now account for a quarter of global trade in industrial products – twice the level in 1980. High tech exports from DCs have increased by 20% annually since 1980, twice the level for industrialised countries<sup>2</sup>.

**The most impressive examples of trade-led growth can be found in Asia.** China is an obvious trailblazer in this sense. Since 1990, trade in goods and services as a percentage of GDP has increased from 32% to 66% while their Human Development index (HDI) – a UN index which combines wealth and quality of life indicators<sup>3</sup> - has increased from 0.627 to 0.755 and annual GDP growth has been 8.5%. Similar trends can be seen in smaller Asian countries, even in the LDCs amongst them - Vietnam increased trade from 81% to 128% of GDP in the same time period, while HDI increased from 0.617 to 0.704 and GDP by 5.9% annually. Bangladesh (an LDC) from 20% to 34% while HDI increased from 0.419 to 0.520 and GDP by 3.1% annually.

**Other regions of the world have also seen success stories.** Dominican Republic increased their trade from 78% to 106% of GDP, its HDI from 0.679 to 0.749 and it's GDP by 4% annually. Mexico increased trade from 39% to 58% and it's HDI from 0.764 to 0.814 and GDP by 1.4%. Other developing countries have seen low or even negative growth, both in trade and in their economies. These countries, overwhelmingly in Sub Saharan Africa (SSA), risk being marginalised from the positive benefits of globalisation.

**However there is evidence that the emergence of new developing country markets is bringing benefits to the poorer actors in world trade.** UNCTAD has recently pointed out the positive impacts which growth in Asia and the resulting increase in consumption is having on other poor regions – particularly those, like SSA, dependent on commodity exports<sup>4</sup>. South-south trade is an increasingly important element of world trade and provides new opportunities for development, but trade barriers are often higher in the south than in industrialised markets. 62% of duties paid by DCs are to other DCs, although they represent only 40% of exports.

**In conclusion, there are strong theoretical reasons to believe that trade is a positive tool for development,** although extensive overnight liberalisation may be too disruptive and a phased and reciprocal approach is most likely to achieve a balanced outcome. Beyond theory we see that many developing countries have used trade, together with sound domestic policies, as a key motor for their development and have seen significant reductions in poverty and increases in welfare. The hope is that these emerging growth economies can bring a new wave of developing countries into the globalisation process. To achieve this, trade barriers need to be reduced both in developing and in developed markets.

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<sup>1</sup> Globalisation, growth and poverty, World Bank , 2001

<sup>2</sup> Human Development Report 2005, UNDP

<sup>3</sup> This is a more useful indicator than GDP growth alone as it combines many elements of quality of life like life expectancy and educational level, which go beyond simple increases in income

<sup>4</sup> UNCTAD (2005) Trade and development report