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Implications of Trade Liberalization for Developing Countries

Dr. Ummed Singh*
Madhu Shankwal**

Introduction

Trade liberalization means reduction of government control over international trade and adopting of liberal policy regarding exports and imports. Restrictions on imports and exports are reduced and imports of several goods are put under open general license category. Import restrictions on several items have been withdrawn and rates of import duties are lowered. The major objective of trade liberalization in globalized economy is to expand trade in the goods and services. Trade liberalization enables a country to enjoy the advantages of specialization according to comparative costs. Every country specializes and exports those goods and services which it can produce cheaper in exchange for what others can provide at a lower cost. When a country specializes according to its comparative advantage and trades at the international exchange ratio, it gains an increase in real income and consequent rise in the standard of living of its people. Thus, trade openness by enabling better and more efficient utilization of the resources of a country its real national income and hence has a growth promoting effect.

It is generally maintained that international trade can serve as a vehicle for the dissemination of technological knowledge. In the initial stages of development developing countries require large scale imports of capital equipment, machinery and technical know-how. This is possible if these countries are able to generate enough export surpluses which, more often than not, they fail to accomplish. Most of the developing countries are exporters of primary products whose supply in many instances is irregular and whose demand in international market is inelastic. While prices of manufactured goods in international markets show periodic increase, the prices of primary goods have shown a stubborn tendency to remain unchanged. Thus the foreign exchange earnings of developing countries are often highly insufficient to generate enough resources to enable large scale imports of capital equipment, machinery and technical know-how.

* Assistant Professor, Department of Economics, University of Rajasthan, Jaipur, Rajasthan, India.
** Assistant Professor, Department of Economics, University of Rajasthan, Jaipur, Rajasthan, India.

There has been different opinion on the role of trade liberalization of a country in its economic development. The classical and neo classical economists have emphasized the growth promoting effects of international trade. They argued that trade liberalization make a crucial contribution in the development of a country. Trade has been considered an ‘engine of growth’. Prof. Haberler argued that international trade can contribute tremendously in the development of the countries only if there is trade openness among the countries because trade is a vehicle for international movement of capital from developed to developing and under-developed countries. Trade liberalization widens the markets and increases the productivity and improvements in productivity result from greater division of labour, higher degree of mechanization and greater possibility of innovation. It has been observed that the trade liberalization widens the extent of the market and the scope of the division of labour, permits a greater use of machinery, stimulates innovations, overcomes technical indivisibilities, raises the productivity of labour and generally enables the trading country to enjoy increasing returns and economic development.

A deficiency of knowledge is a big handicap in the development of developing countries and this deficiency can be effectively removed through contact with more advanced economies which is made possible by trade liberalization. The import of technical know-how and skills is an indispensable source of technological progress. According to J.S. Mill, trade benefits the less developed country through the introduction of foreign technical know-how, which raised the returns derivable from additional capital to a rate corresponding to the low strength of the desire of accumulation. Furthermore, by installing new ideas and breaking the chain of habits, it tends to create among inhabitants of the country new wants, increased ambition and greater thought for the future. Thus, the trade liberalization has an immense educative influence on the people of developing countries and can thus help in bringing about technological and industrial revolution. Removal of the restrictions from trade, foster healthy competition and control the inefficient monopolies. The more competitive an economy is, the more efficient it will be. The World Commission (2007) in this context conveys, “This trade expansion did not occur uniformly across all the countries, with the industrialized countries and a group of 12 developing countries accounting for the lion’s share. In contrast, the majority of the developing countries did not experience significant trade expansion. Indeed, most the least developed counties a group that includes most of the countries in sub-Saharan Africa experienced a proportional decline in their share of world markets despite the fact that these countries had implemented trade liberalization measures.”

Supporters of trade liberalization claim that opening of indigenous markets to global competition and overseas investment will contribute to higher competitiveness of domestic industries, leading to more productive capital distribution and considerably higher overall output and growth. Critics caution that local firms may be likely to achieve productivity benefits as they are struggling to adapt global developments effectively to domestic manufacturing practices or because local firms face contractual credit restrictions that hinder the growth of competitive enterprises as well as investments in new technologies.

Table 1: Exports from India (1983-84 to 2016-17)

Year	Incl. Re-Exports (Rs. in Crore)	Year	Incl. Re-Exports (Rs. in Crore)
1983-84	9770.70	2000-01	201674.10
1984-85	11743.70	2001-02	209017.97
1985-86	10894.60	2002-03	255137.28
1986-87	12452.00	2003-04	293366.76
1987-88	15673.70	2004-05	375339.53
1988-89	20231.50	2005-06	456417.80
1989-90	27658.40	2006-07	571779.20
1990-91	32553.30	2007-08	655863.50
1991-92	44041.80	2008-09	840755.10
1992-93	53688.30	2009-10	845533.59
1993-94	69751.40	2010-11	1142921.72
1994-95	82674.10	2011-12	1465959.19
1995-96	106353.40	2012-13	2429015.00
1996-97	118817.90	2013-14	2818695.00
1997-98	130106.00	2014-15	2846533.00
1998-99	139751.80	2015-16	2746636.00
1999-00	162924.90	2016-17	2930041.00

Source: Various issues of Economic Survey

Due to trade liberalization India is able to access foreign markets more effectively. It is clear from the table 1, 2 and 3. Table 1 shows that there has been a rapid growth in exports from India. Because India has been able to take advantage of its expertise in IT sector. There have been some improvements in the current account deficit. The pattern of exports has also undergone change. Earlier there was a dominance of primary products in exported items. The 1982-83 the exports were 4.8% of GDP and increased to 12.3% in 2016-17. But as can be seen from the table 3 the increase in imports has been higher than the growth rate of exports.

Before economic reforms India's trading environment was among the highly stringent in Asia, with heavy nominal tariffs and substantial non-tariff barriers including a comprehensive import regulatory scheme, a 'real consumer' policy limiting imports by intermediaries, limiting some exports and imports into the government sector ('channeling'), staggered manufacturing systems requiring incremental import substitution. It was during the mid-1980s, when economic and social development policy slowly changed to export-led expansion, backed by export-promoting initiatives and export-liberalizing imports that the deregulation process started. Imports and industrial licenses were relaxed, and quotas were removed.

In August 1991, India's government urged a Stand-By setup from the International Monetary Fund to address its the outside liquidity problem. Help from the IMF was based upon an adjustment package of macroeconomic stability and structural reforms. The latter concentrated on permissions for manufacturing and imports, the banking market, the tax structure and foreign policy. On trade relations, the targets for the first analysis of the Stand-By Agreement included a decrease in high tariffs and dispersion, and the elimination of numerical limitations on imported inputs and capital goods for export output.

Table 2: Product-wise Share in India Exports (Gainers and Losers) (1990-1991 and 2002-2003)

(Percent)

Item	Share in India's Exports		Growth rate 1990-91 to 2002-03@
	1990-91	2002-03	
Gainers			
Primary & Semi-Finished Iron & Steel	0.6	3.0	25.2
Plastic & Linoleum	0.6	2.2	21.4
Manmade Yarn, Fabrics, Madeups etc.	1.3	2.5	15.8
Electronic Goods	1.3	2.2	14.1
Petroleum Products	2.9	4.6	13.6
Drugs, Pharmaceuticals & Fine Chemicals	3.1	4.7	13.1
Losers			
Cotton Raw including Waste	2.6	0.0	-27.6
Finished Leather	5.2	0.9	-5.4
Tea	3.3	0.6	-4.7
Footwear of Leather	2.8	0.8	-1.7
Iron Ore	3.2	1.6	3.3
Readymade Garments: Man-made Fibre	2.5	1.3	3.8

@:Growth rate of exports in US dollar terms.

Compiled from the statistics released by: Report on Currency and Finance (2002-03), Reserve Bank of India.

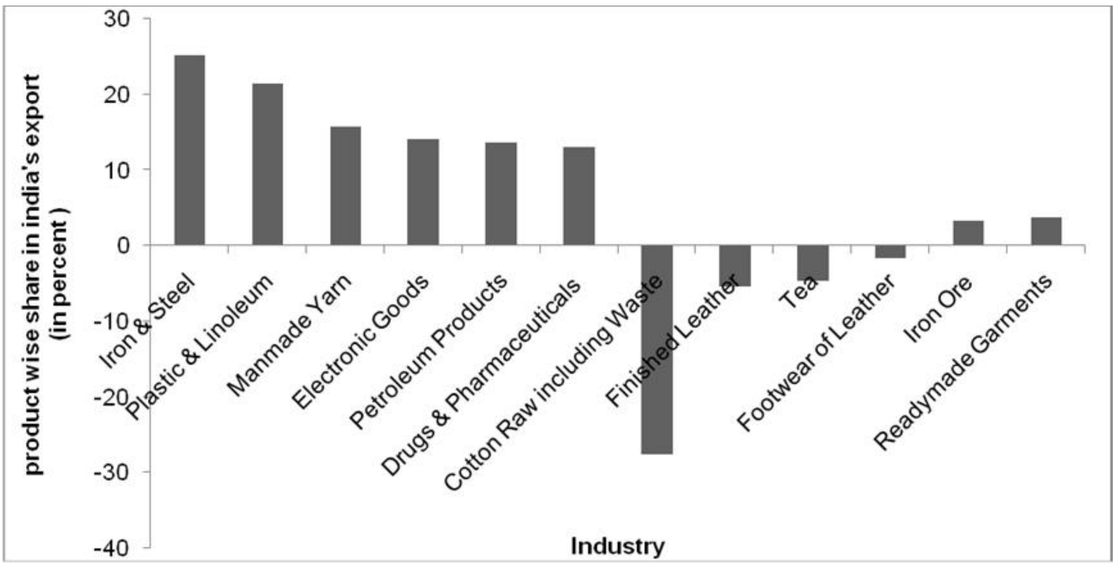

Fig.: Product-wise Share in India Exports (Gainers and Losers)

Table 3: Trade and Invisible Pre and Post Trade Liberalization

(Percent)

Year	Trade		Invisibles		
	Exports/GDP	Imports/GDP	Receipts/GDP	Payments/GDP	Net/GDP
1982-1983	4.8	8.3	3.2	1.4	1.8
1983-1984	4.6	7.7	3.1	1.5	1.6
1984-1985	4.8	7.5	3.3	1.8	1.5
1985-1986	4.1	7.5	2.8	1.5	1.3
1986-1987	4.2	7.2	2.6	1.5	1.1
1987-1988	4.6	7.2	2.6	1.8	0.8
1988-1989	4.9	8.1	2.6	2.1	0.5
1989-1990	5.8	8.3	2.6	2.3	0.2
1990-1991	5.8	8.8	2.4	2.4	-0.1
1991-1992	6.9	7.9	3.6	2.9	0.7
1992-1993	7.3	9.6	3.6	3.0	0.6
1993-1994	8.2	9.7	4.1	3.1	1.0
1994-1995	8.3	11.1	4.8	3.1	1.8
1995-1996	9.1	12.3	5.0	3.4	1.5
1996-1997	8.8	12.6	5.5	2.9	2.6
1997-1998	8.7	12.5	5.6	3.2	2.4
1998-1999	8.2	11.4	6.2	4.0	2.2
1999-2000	8.3	12.3	6.7	3.8	2.9
2000-2001	9.9	12.6	7.0	4.9	2.1
2001-2002	9.4	11.8	7.7	4.6	3.1
2002-2003	10.6	12.7	8.3	4.9	3.4
2003-2004	11.1	13.3	8.9	4.3	4.6
2004-2005	11.8	16.5	9.6	5.3	4.3
2005-2006	12.6	18.8	10.8	5.7	5.0
2006-2007	13.6	20.1	12.1	6.6	5.5
2007-2008	13.4	20.8	12.0	5.9	6.1
2008-2009	15.4	25.2	13.7	6.2	7.5
2009-2010	13.4	22.0	12.0	6.1	5.9
2010-2011	15.0	22.4	11.1	6.5	4.6
2011-2012	17.0	27.4	12.0	5.9	6.1
2012-2013	16.8	27.5	12.2	6.4	5.9
2013-2014	17.2	25.1	12.6	6.4	6.2
2014-2015	15.6	22.7	11.9	6.1	5.8
2015-2016	12.7	18.9	11.2	6.0	5.1
2016-2017	12.3	17.3	10.6	6.3	4.3
2017-2018	11.9	18.0	10.9	6.6	4.3
2018-2019	12.4	19.0	11.3	6.7	4.5

Abbr.:GDP: Gross Domestic Product.
Note: Current receipts are defined as current account receipts minus official transfer receipts.
Source: Reserve Bank of India. (ON595), (ON1220) & Past Issues.

Growth Retarding Effects of Trade Liberalization

Historically the market forces of globalization and liberalization have impeded the development of developing countries. These forces have created dual economies in the developing countries as result of which the export sector became an island of development while the rest of the economy remained backward. The effects of international factor movements have been that of creating a highly unbalanced structure of production in these countries. The opening up of the export markets gave a fillip to their export sector which led to the development of this sector to the utter neglects of other sectors of the economy. Although export increased but they have not contributed much to the development of the rest of the economy. Moreover, excessive dependence on export exposed their economy to cyclical fluctuations in the advanced countries. During depression, terms of trade become adverse and their foreign exchange earnings fall steeply. They were also not able to take advantage of world boom because any improvement in their balance of payment does not lead to increased output and employment because of market imperfections and non-availability of capital goods.

The international movement of factors has also not been entirely beneficial to developing countries because of the adverse effects of foreign investments on their economy. It has been maintained that the inflow of foreign capital has developed a country's natural resources only for exports purposes, to the neglect of production in the domestic sector. Foreign enterprises have transformed the exports sectors into the most advanced part of the economy but this imported capitalism did not penetrate very fast into the indigenous economy. In these countries the exports sector remains an island of the development surrounded by a backward low productivity sector. Thus, the inflow of foreign capital in developing countries has not resulted either in the development of the domestic sector or of the people in these countries. Despite huge foreign investment, the people of these countries remained backward.

The international operation of the demonstration effect has been a handicap for the developing countries. It has been responsible for reducing the capacity for capital formation. The desire of imitate the standard of living and pattern of consumption of advanced countries has been an important factor responsible for the low level of domestic savings in developing countries. Higher income groups in these countries are trying to imitate the consumption standard of advanced countries which has pushed up their propensity to consume and thereby limited the capital accumulation and economic growth.

Another important criticism of trade liberalization has been that it has resulted in an international transfer of the income from the developing to rich countries through circular deterioration in the commodity terms of trade of the developing countries. There has been a secular deterioration in the terms of trade of developing country due to fact that their exports items are mainly primary products whose income and price elasticity are quite low. Over the last seventy years, the peripheral under developed countries have suffered with the fatal effects of the continuous weakening in their capacity of imports. It has led to weakening of the capacity of their existing primary producing industries to support their growing population. It has resulted in a failure to transmit to them the benefit of technical progress. It has made every indiduval independent efforts to raise the productivity of its primary producing industries leading to the deterioration of terms of trade, unemployment and balance of payments disequilibrium. It has finally lowered their rates of capital formation and thus of their growth. The benefits of technological progress have gone disproportionately to the advanced countries. The benefits of trade liberalization and investment have not been equally shared between the two groups of countries. The capital exporting countries have received their repayment in many times. The foreign trade of traditional type has formed part of the system of economic imperialism. In a bid to keep down imports of non-essential goods, stringent import controls have to be introduced and the import of a number of consumer goods has be banned. This serves as an incentive to the domestic production of these goods. It is hoped that over a period of time the infant industry will become sufficiently strong to grow up and be able to compete in the world markets.

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