

Trade Liberalisation : Can Restriction and Protectionism ever be a sound policy

Trade liberalization or free trade is a highly contested subject, especially in the current global financial scenario and ongoing economic recession and slowdown, which draws feverish support and equally violent condemnation. Whether trade liberalization hurts the poor or not is itself a matter of great debate and difference of opinion, one that can be seen in the recent latest move to allow Foreign Direct Investment (hereinafter FDI) by the Indian Government, and the varied reactions from both sides of the spectrum.¹ There are arguments that Trade liberalization helps in growth and growth ultimately helps in lowering poverty, but on the other hand the uniformity of the benefits of globalisation and trade liberalization is questioned. Arguments against trade liberalization claim that it can cost jobs and even lives, due to cheaper goods not facing the stringent checks at the market, or due to the loss of livelihood due to competition.² Proponents and supporters, claim trade liberalization ultimately lowers consumer costs, fosters economic growth while maximizing efficiency.³ In this essay an effort is made to point down the basic aspects of trade liberalization and free and open market, how they benefit, and how they hurt poor, if at all, and when.

Trade Liberalization : The Arguments

Trade liberalization or openness can be defined as “ The openness of an economy is the degree to which nationals and foreigners can transact without artificial (that is governmental imposed) costs (including delays and uncertainty) that are not imposed on transactions among domestic citizens. “⁴ So, in other words, it is free exchange of goods between nations, and removal or reduction of restrictions and barriers in the borders and policies, and includes dismantling of tariff (duties and surcharges) and non-tariff obstacles (like licensing rules, quotas and other requirements). Trade liberalization can provide a massive shock to the economy, and one of the immediate micro effects would be a decrease in prices of imported goods, and a possible increase in the prices of the exports. Thus it would generally help in the overall standard of living for the

¹ “ Indian Reforms: AT LAST “ The Economist, September 22, 2012. <http://www.economist.com/node/21563329>

² Investopedia : Definition of Trade Liberalization

³ Ibid

⁴ “Trade Growth and Poverty “ IMF working paper, February 2003, Andrew Berg and Anne Krueger, pg 5.

poor people, as they would have saved income even after spending on consumerism. Also, low prices and greater competition keeps the domestic goods price low, and benefits the consumer. The increase in capital goods flow and competition influence the employment and wages. The benefits can be seen with a Stolper-Samuelson theorem, which states that a relative increase in the price of commodity will increase the real return to the factor used intensively in that industry. In a developing country, trade liberalization helps increase in relative prices of labour intensive products, and relative wages, demand for unskilled labour and employment. Stolper-Samuelson theorem is however based on perfect labour mobility, and zero policy distortion, which is not true in every developing country. Country studies as diverse as ranging from India to Poland, shows that labour mobility is also not similar or uniform, at times hardly mobile.⁵

Competition is also a very important factor when it comes to trade liberalization and its effect on the poor. There is an argument that opening of the economy, benefits workers by making it possible to export more goods, at a higher price, which will in turn lead to higher profits and incomes, and better standard of living for the poor. But on the other hand there is also an argument, that if such sectors, which were protected by trade liberalizations, if they were opened up, it might hurt the poor badly, as a lot of domestic firms will die away in front of competition from firms from outside. Generally it is seen that in developing countries, the sectors which are traditionally protected, like manufacturing, textiles or fast food and drinks, suffer massively as they cannot compete with multinational brands. With loss of Government protection, like stoppage of subsidies, firms become uncompetitive, and shut down, thus in “short run” there might be massive unemployment and increase in poverty.

However, efficiency and competition in the long run increases productivity. And higher productivity increases the growth rate of an economy. Global Poverty Report of 2001 states that trade liberalization can be beneficial in the long term, as it helps in making investment more efficient, allows FDI, which in turn increases the participation of newer technologies, and more productivity. Overall productivity also increases overall growth, and FDI and foreign investment increases employment and business opportunities in different sectors, which balances the employment loss resulting from the removal of protectionism. The liberalization of Indian

⁵ “On the links between globalization and poverty” – Ann Harrison, Margaret McMillan, December 2006, Science and Business Media

centralized and command economy during the early nineties led to quite a few public sector job losses, but subsequently with the opening and free competition and influx of Multi National Companies, the service industries notably IT and Telecom and Pharmaceuticals, led to massive employment and growth compensating for the earlier shock.

Open Trade and Poverty

If we exclude sub-Saharan Africa and parts of Eastern Europe, extreme poverty rates are lower today than they were 20 years ago, percentage of world population living under extreme poverty has fallen from 30 percent to 17 percent in the last two decades.⁶ Two important and interesting examples of the benefits of trade liberalization are that of China and India.⁷ China from 1980 to 1992, immediately after their liberalization per capita income grew by 3.6 percent per annum, Even though GINI coefficient increased from .32 to .38, which is a massive increase in inequality by international standards, the actual number of poor fell by around 250 million. In India, in two stages of liberalization, around 1991 and 1996, poverty fell “dramatically” from 35 percent in 1987/88 to 29 percent in 1993/94 and to 23 percent in 1999/2000.⁸

Often it is seen that Trade liberalization is not enough for the economy to grow. A lot of African countries liberalized their economy, during or around the same time when China, Indonesia and India opened their market, starting from the early eighties to early nineties. But the African countries didn't experience the same benefits. Similarly all the Eastern European formerly communist countries liberalized their highly centralized economy during the same period, but their growth pattern was not the same, it was highly uneven. One of the reasons for that maybe that trade liberalization only helps create opportunities but to sustain them massive structural and institutional reforms are needed along with. For example, infrastructure, education, technological knowhow, appropriate exchange rates are needed alongside trade reforms, to make the benefits from the reforms more sustainable. For example, Poland, or any East European country

⁶ Ibid

⁷ “Trade Growth and Poverty “ IMF working paper, February 2003, Andrew Berg and Anne Krueger, pg 4.

⁸ Ibid

benefitted hugely from trade liberalization, as although they were communist before, they had the base for good industrial investment, like roads and hospitals. Countries from Sub Saharan Africa like Zambia for example, lacked in these regards

An effect which is more or less regarded to be backed by solid empirical evidence is that countries see a decline in poverty, regardless of their position in world trade. The inequality gap may rise, but there is overall a decline of poverty. Examples as diverse as Zambia, Poland and Colombia, with completely different socio-economic background, prove that Globalization and trade liberalization basically helped in the lowering of poverty. “The study on Zambia suggests that poor consumers gain from falling prices for the goods they buy, while poor producers in exporting sectors benefit from trade reform through higher prices for their goods. In Colombia, increasing export activity has been associated with an increase in compliance with labor legislation and a fall in poverty. In Poland, unskilled workers – who are the most likely to be poor – have gained from Poland’s accession to the European Union.”⁹ Harrison/McMillan claims in their analysis. It doesn’t mean that the prosperity came from the same working solutions though. For example in the case of Poland, it was due to easy labor mobility across Europe, whereas in the case of Zambia and Colombia, it was due to competition and exports. Also, notably it is a common factor that poor countries would grow faster than comparatively rich countries, if they are well integrated and they have proper functioning institutions. There can be over time, absolute convergence, the literature on growth theorizes. Foreign investment has different effects on different countries though, depending their macroeconomic stabilization policies, and exchange rate flexibility. Factors like infrastructure can be the determining factor behind the success or failure of trade liberalization in a country. Also massive internal market can neutralize the shock of trade liberalization, like India, Indonesia and China could absorb the shocks comparatively better than Colombia or Argentina, being domestic consumption driven economy, being dependent on domestic markets more than less export sector performance.

There is ample evidence that Globalization and trade liberalization produces both winners and losers, but it is highly difficult to corroborate them into a solid hypothesis, as the data collection is extremely difficult and varied. Even in a single region, two different outcomes can be found

⁹ “On the links between globalization and poverty” – Ann Harrison, Margaret McMillan, December 2006, Science and Business Media

for two different factors, depending on their two completely varied approaches to trade liberalization. “The heterogeneity in outcomes associated with poverty– globalization linkages is one theme that emerges from a number of the different country case studies. “¹⁰ as per Harrison/McMillan. Also, different measures and degrees and approaches to trade liberalization can have different results. The difference of data, the difference of statistics, and the generalization of different approaches can give highly unsatisfactory answers to the impact of trade liberalizations, but according to Berg/Krueger some common factors can be derived, as increase in competition leading to lower prices and better quality of goods, leading to general betterment of poor consumers. Also, trade liberalization helps poor farmers, as generally in the developing countries, a major percentage among the poor are engaged in small scale agriculture.

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Will Protectionism help?

There is an argument that the poor can be protected with trade restrictions and protectionism. Protectionism in economic terms can be explained as a tendency to stifle free trade or competition with tariffs, duties, levies, subsidies, license or quotas, and the proponents argue that protectionism is beneficial for a lot of reasons. The main reasons are that comparative advantage has lost its legitimacy and meaning, as capital is free to move across the globalised integrated world, nascent and infant industries should be protected, to a position where they can grow and compete, and finally, Laissez Faire capitalism and unrestricted competition creates social evil.

For a start, protectionism has been criticized by almost the majority of economists across the spectrum. The biggest criticism is that protectionism promotes incompetence. The infant industry idea is completely baseless as the industry will remain infantile and shelled in a cocoon, if it never faces the competition from outside. Also, one important thing which is compromised in protectionism is quality of goods and the consumers are the biggest losers. It is not clear how many jobs protectionism and trade restrictions can actually save, maybe some jobs in the short

¹⁰ Ibid

¹¹ “Trade Growth and Poverty “ IMF working paper, February 2003, Andrew Berg and Anne Krueger, pg 33.

run in some industries, but it “prevents the expansion of jobs in similar industries”.¹² A simple but prudent example would bring us back to India, where in 1984; there was only one private car manufacturer, the “Ambassadors”, which churned horrible, technologically inferior behemoths, unavailable to the mass other than the elites. After liberalization, now not only there are innumerable choices, but great competition which assures production quality at the highest and world standard, prices low, and different domestic car manufacturing and auxiliary industries guarantying jobs for millions.¹³

The trend of protectionism is growing however, alarmingly across the World. Director General Pascal Lamy of WTO, warned against trade restrictions, in a speech in June 2011, during the height of global recession, that the “protectionist pressures remain and are being generated by stubbornly high levels of unemployment in many countries, persistent global imbalances, and macroeconomic concerns”¹⁴ Recently EU parliament called for tighter restrictions on bank’s trading activities, and opposed greater competition between clearing houses.¹⁵ Also there is a growing tendency of Economic Patriotism in United States which can be detrimental for consumers.¹⁶

Conclusion

To summarize, trade liberalization effects on consumer pattern and income patterns of the poor, and even though there are opposing views and ambiguity on the changes in wages and welfare of the poor, overall it should be encouraged for the following reasons. Trade pessimism never helped any country, simply because we live in a globalized world, and centralized or autarkic economy will find it hard to survive. A lot of arguments against trade liberalization come from

¹² “Poverty and Protectionism” , Stephanie Y Wilson.

¹³ “Protectionism harms consumers and the environment” , Kendra Okonski and Caroline Boin, International Policy Network, London.

¹⁴ “Trade Restrictions on the rise” : June 2011, Pascal Lamy, WTO speeches,
http://www.wto.org/english/news_e/sppl_e/sppl196_e.htm

¹⁵ “EU Parliament backs tighter trading restrictions”, Financial Times, September 26, 2012
<http://www.ft.com/intl/cms/s/0/23e9089c-06ff-11e2-92ef-00144feabdc0.html#axzz2820YbGnl>

¹⁶ Made in USA only campaign. <http://www.madeinusa.org/>

countries like sub-Saharan Africa, which are maybe due to flawed institutional and structural systems, or due to the overall scenario of investment, materials, productivity and a lot of other factors, trade liberalization is not as beneficial for the poor as it was supposed to be. Chronic political instability is also a major factor in these countries. The assessments don't include liberalization of services, trade facilitations, elimination of licensing and non tariff barriers, domestic reforms or markets, and most importantly welfare of workers, which can have massive repercussions for the mass and could potentially blunt any move to open up free trade.¹⁷ The fact that trade liberalization worked for certain countries poor and not for others are a testimonial that it is not the concept of liberalization, but the factors and modes to liberalize is what matters for the poor. That being said, more research is needed to actually integrate the poor so that a vast majority of the downtrodden living below poverty line across the world can have equal opportunities. Identification of the problems in Latin America or Sub-Saharan Africa, and employing the solutions is the hardest challenge facing humanity. Even though the overall percentage of poverty has declined, but the number of people living under dollar two a day has increased enormously, mostly in sub-Saharan Africa. More research needs to be done to identify the causes and act for the remedy. If not provide the guarantee to feed every mouth on planet, atleast to provide the opportunity to tap in the benefits of globalization.

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¹⁷ "How much will trade liberalization help the poor? Comparing Global trade models " Antoine Bouet, International Food Policy Research Institute.

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