Trade Liberalization & WTO: Impact on Developing Countries

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Abstract:

The international movement towards open markets prompted by the World Trade Organisation (WTO) has its premise that trade liberalization will benefit all those who are concerned. Each country will be able to exploit its position of comparative advantage, once a free and fair trade regime has been implemented. After the Second World War, world trade has been growing continuously due to a number of factors. In particular, the liberalization of trade restrictions and advent of WTO in recent times have expanded the trade between the international communities. This article traces the factors responsible for this phenomenon as well as the impact of liberalization of trade on developing countries.

Key Words: Merchandise trade, globalization, Liberalization, Terms-of-Trade, Subsidy

What is WTO?

The World Trade Organisation (WTO) is an international organization dealing with the global rules of trade between nations. Almost all the nations have realized that days of unilateral or bilateral negotiations are over. It is an edge of multilateral trade and negotiations and the WTO exactly stands for the same. It started its operations on January1, 1995, but its trading system is half a century older. Since 1948, the General Agreement on Tariffs and Trade (GATT) had provided some general rules and regulations for the system. The largest GATT round, was the Uruguay Round which lasted from 1986 to 1994 and led to the WTO's creation. GATT had a short dimension which mainly dealt with trade in goods whereas the WTO has come up with a broad dimension which covers trade in services, and in traded inventions, creations and designs (intellectual property).

World Exports and Trade Performance of Developing Countries:

After World War II there has been a near continuous and extra-ordinary rapid growth in world trade. In 2005, the world's real merchandise exports rose by 6.5 per cent. In real value terms, the world merchandise exports increased by 13 per cent to 10.1 per cent trillion dollar[1]. Germany maintained the top of the list with $ 971 billion and 7 per cent growth, while the US placed second with $ 904 billion and 10 per cent growth. While among the Asian countries China's export earning records $ 762 billion with 28 per cent growth, exceeding Japan's export record of $ 596 billion with only 5 per cent growth. India, the leading performer in South Asian trade, earned $ 90 billion in 2005 with 19 per cent growth. According to WTO, world merchandise trade grew 8 per cent in 2006. This one was the second highest remarkable performances since 2000. World commercial service exports rose by 11 per cent to $2.7 trillion in 2006 at the same annual pace since 2000. This transcends the optimistic GDP growth – 5.4 per cent. This has been observed by the world in 2006[2]. In 2006, the trade expansion in developing countries was favorable. Share of world merchandise exports reached an all time record of 36 per cent. The country like China, since 2000, has more than doubled its share in world merchandise exports and ranks as the third largest exporter and importer in merchandise trade. In spite of its strapping export growth, China remained the third largest merchandise exporter in 2006. However, in the later half of 2006, the merchandise exports of China exceeded those of the United States for the first time[3]. According to Mukul G. Asher[4], "India's merchandise trade has grown rapidly in the past two decades; it has been accompanied by a change in the direction towards Asia". The share of India's trade with developing Asia (mainly including China, Korea[5], SAARC and ASEAN-4 countries) had been doubled from 12 per cent to 24 per cent over the 1987-2004 periods.

All economies are increasingly open in today's economic environment of globalization. International trade plays a vital role in shaping economic and social performance and prospects of countries around the world, especially those of developing countries. Without trade, the economic and social condition of the country cannot progress. However, the contribution of trade to development depends a great deal with the context in which it works and the objectives it serves. In recent years, many developing countries, have stepped upon unilateral trade liberalization, with very limited results at best in terms of increased growth and development[6].

The rate of growth of emerging and developing countries are expected to grow continuously in the year 2007 even though it is to some extent slower pace than in 2006. China's growth is anticipated to remain rapid in 2007 and 2008, even though its pace is little below than that of 2006, while India's economy should also continue to grow rapidly.

The increase in the value of exports has been both due to an increase of export prices and also an increase in the volume of exports. But the increase in the value was a profound factor, the world export volume index in 1997 being 156 (1990-100) as against the unit value index of 103. In the decade of 1980s, the volume of world trade increased by 50 per cent and its value in dollar terms rose by 75 per cent

The rate of growth in world trade has always been higher than the growth in world production. During the period 1950 to 1994, the volume of world merchandise trade increased at an annual rate of 8 per cent and the world output increased by close to 5 per cent. The following table makes the position clear;

World Output and Trade

Period	***Percentage growth in***	
	Output	***Trade***
1913-48	0.5	2.0
1948-73	5.0	7.0
1973-83	2.0	3.0
1980-91	2.3	5.1
1991-2000	2.3	6.8
April 2006*	4.9*	8.0**

Source: Varshney,R.L , "Developing Countries and World Trade", Dec 2002 , pp 1663

* World Economic Outlook, International Monetary Fund, April 2006

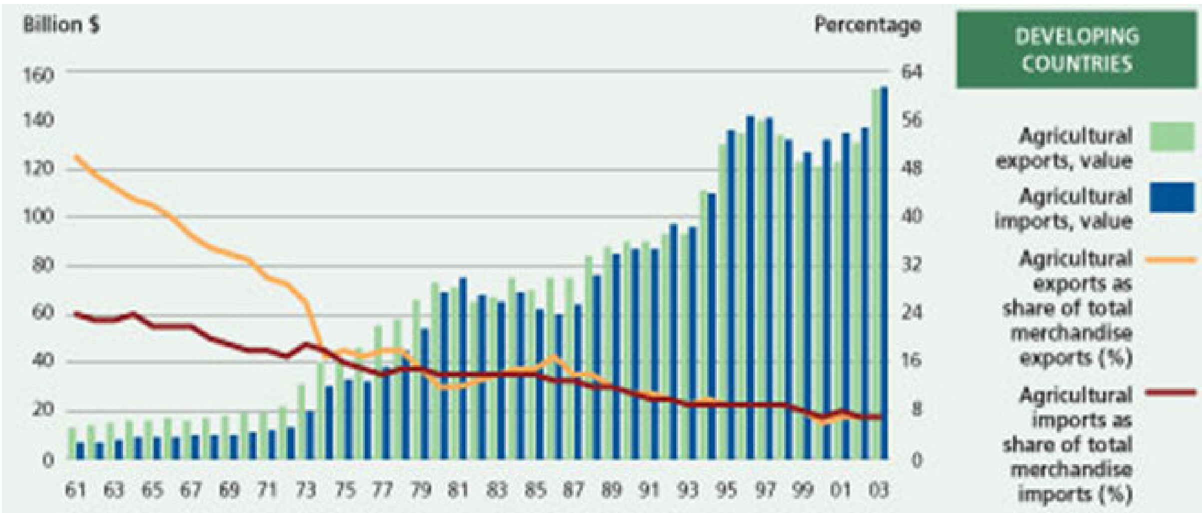
** http://www.wto.org/english/news_e/press07_e/pr472_e.htm (World Trade 2006, prospects for 2007)

The increase in world trade has been due to a number of factors. In the post World War II period, vigorous expansion of the world economy, partly due to Government policies aimed at ensuring economic growth, has provided the principal impulse for the growth of world trade. The increase in overall growth rates also resulted in a vast and widely disseminated increase in personal incomes which gave rise to an increased demand for imports. Gradual liberalization of trade restrictions and import controls, reduction in customs tariffs and the vigorous export promotion activities have also contributed in the growth of world trade. The increased flow of funds from the economically advanced countries to the developing ones have also helped in the growth of world trade. Along with these the global peace, greater speed and capacity of communications, lower cost of transportation[7], and rapid development of Transnational Corporations (TNCs) have also contributed in the growth of world trade. They have recognized the markets, mobilized manpower and financial resources, developed and implemented research and have carried on manufacturing and marketing on a global basis.

Constraints Facing Developing Countries:

Most of the developing countries are exporters of primary goods. In the present day world, the demand for food and agricultural raw materials has declined. During the 1990s, the share of agricultural trade in total merchandise trade had been declining continuously. In the developing countries, the share of agricultural exports in total merchandise exports had fallen from almost 50 per cent in the early 1960s to only 7 per cent in 2003. Until the early 1990s, the developing countries recorded an agricultural trade surplus. Over time, this traditional surplus position had been decreasing and right through most of the 1990s agricultural exports and imports in the developing countries were almost in balance, turning to a trade deficit in 1999 (Figure 1).

Figure: 1



Source: http://www.fao.org/docrep/008/a0050e/a0050e09.htm

Food and Agriculture Organization's (FAO) stance in 2030 suggests that, as a group, the developing countries will become net agricultural importers and projects a developing country agricultural trade deficit of $18 billion (in 1997/99 US dollar terms) in 2015, rising to $35 billion in 2030 (FAO, 2002). In the developing countries the agricultural exports has fallen due to following factors:

(i) Technological advances leading to a drastic fall in the requirements for raw materials and fuels per unit of manufacturing output in industrial countries.

(ii) Growing complexity and sophistication of final products, all of which tend to reduce the input of raw materials per unit of output;

(iii) The evolution and intensified use of manufactured (synthetic) raw materials, such as rubber, fibers and leather; and

(iv) The rising productivity of agriculture in the industrial countries.

Even though developing countries are major exporters of agricultural goods, their share declined from 45 per cent in 1970 to 29 per cent in 1987. The share of processed agricultural goods within total agricultural exports decreased from 23 per cent in 1980–1983 to 18 per cent in 2000–2003 (UNCTAD 2006). In 2006, trade of agricultural products represents no more than 10 per cent of all merchandise trade (Doha Development Agenda 2006)[8]. With the conclusion of Uruguay Round of Trade Negotiations and the proposed reduction in agricultural subsidies, the share of developing countries in farm exports was expected to increase but the hopes have not materialized[9].

Nowadays, developing countries are facing another problem regarding the increased volatility of world prices of agricultural goods since 1972. Again, the cyclical pattern in prices of agricultural commodities has not been affected by the WTO regime. For developing countries, the world agricultural prices have gone down below their (Developing Countries) prices in the last few years. As a result, demand for agricultural goods fall sharply in the world market. On the other hand, developed countries sale their agricultural goods in the world market at a low prices compare to developing countries. So, the lion share of the world export of agricultural commodities has been captured by the developed countries.

The event of September 11, 2001[10] has hit the commodity prices so badly that most of the major commodity price indices showed substantial decline in 2001 and remained below the 1997 levels. There were large decline in the prices of tea and coffee, commodities of major interest to developing countries. Prices of rice, copper, cotton and natural rubber declined[11]. The economic impact of this decline was reflected in a pronounced deterioration by an estimated 3 per cent in the terms of trade of developing countries[12]. In fact, developing countries have been facing an adverse movement in their terms of trade[13]. To understand how export and import prices affect a country's terms of trade, we consider an example in which a country exports rice and imports oil. Increases in the price of oil represent a deterioration of the terms of trade because the country will pay more for the goods it imports. Conversely, increases in the price of rice increase the country's export earnings and represent an expansion in its terms of trade. One recent study (Baxter and Kouparitsas 2000) suggests that terms-of-trade fluctuations are twice as large in developing countries as in developed countries. Developing countries export more commodity products, whose prices are more volatile than those of manufactured goods. Moreover, because developing countries generally have a high degree of openness to foreign trade, these sharp swings in the terms of trade affect a large share of their economies[14].

Protectionist Measures in Developed Countries:

The significant barriers that still remain after the establishment of the WTO are[15]

(i) Among the Asian countries in the sample, the share of agricultural tariff lines with bound duties above 100 per cent ranges from zero to 69 per cent, while among European countries the figure ranges from 1 per cent to 45 per cent.

(ii) In services the two most important modes of supply are mode 1 (cross-border supply) and mode 3 (supply through commercial presence). So far members appear to have concentrated much of their negotiating effort on mode 3. There may, however, be a greater focus on mode 1 commitments in the current negotiations as a result of the growth of e-commerce.

Impact of Liberalization of Trade:

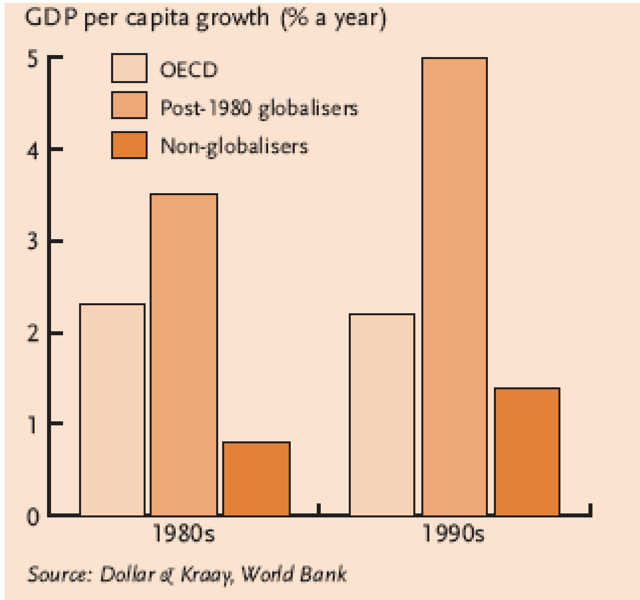
The economic well being of a country is associated closely to the availability of resources and the productivity of its workforce. Trade operates in a diversify ways to sustain the economic development process. It enhances competition and the linked thrust to innovation and specialization, and it provides a significant channel for international technology transfer[16]. Therefore, it is not astounding that economists include trade among the classical drivers of economic growth.

Trade liberalization helps to enhance the economic growth of the nation and reduce the level of poverty:

(i) 3 per cent of world exports of goods, equivalent to $2,275 billion, were attributable to WTO/GATT's function in facilitating growth in trade more than 50 years in the year 2003[17].

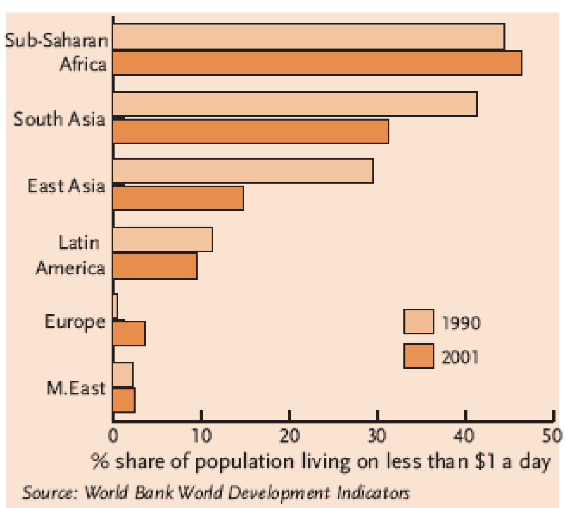
(ii) In 1990, the average annual growth rate of more globalize developing countries were 5 per cent against 1.4 per cent for less globalize countries and over 2% a year in high income countries (Figure 2).

Figure 2: Divergent Growth Rates in Developing Countries



(iii) While achieving the highest growth rates, developing countries have been able to reduce the level of poverty remarkably. Share of population earning less than $1 a day halved from 30 per cent to 15 per cent in East Asia and cut down by a quarter from 42 per cent to 30 per cent in South Asia between 1990 and 2001 (Figure 3).

Figure 3: Change in Percentage share of those in poverty



(iv) Openness to international trade is connected with investment climate (both foreign and domestic), which is positively correlated with economic growth. When markets are open and are free from all barriers then private investors get better opportunity with reduced uncertainty whereas previous barriers might have restricted their business. Private investment brings intellectual capital and technology, and can also push other aspect of social infrastructure in a positive direction.

(v) The financial service sectors are also enhanced due to opening up of trade. This can mobilize resources for domestic and foreign investment.

Winners and losers:

There is a large consensus on the overall benefits provided by trade and openness. Yet the debates are still going on, especially with respect to the measures of openness and the choice of base years[18]. There are big uncertainties to the developing countries regarding the fairness and true objectives of the proposals originating from the developed countries. These uncertainties will continue if the developed countries keep up the practice of recommending selective trade openness (which seems to be proportional to the geopolitical weight of developed as well as developing countries), to protect their own sensitive sectors for their own interest. On the other hand, they oppose projects for abolishing barriers for the least developed countries. Fair initiatives and concessions reaching to the poorest countries may imply losses for other developing countries augment competition between them and may also reduce preferences that they have been enjoying previously. The fact of Asian crisis has intensified the doubt of many developing countries that, globalization is a “rich country’s game”, whose rules favor the most competitive ones[19]. Developing countries are conscious that even the few commodities they export are not always competitive. Moreover, especially in Sub-Saharan Africa, the *Bretton Woods* institutions may have contributed to the erosion of the few comparative advantages that they possess. The impact of globalization and liberalization may lead to the coming out of new losers as well as winners to some of the countries. As we have seen that, trade liberalization helps to reduce poverty it may also increase poverty in certain cases, depending on the market structure, wages, level of skills in the export sector, and so on[20]. From surveys it reveals the fact that in some countries, trade liberalization has intensified inequality[21]. Positive link between growth and trade openness have been challenged by the number of scholars as measured by lower tariffs and non-tariff barriers[22]. The matter of globalization in itself is not harmful or beneficial; it is formed by those who design the rules and regulations[23]. Thus, Globalization can be the part of the solution provided; its benefits are shared equitably by all and not be the problem for the economy of the developing country.

Footnotes:

1. International Monetary Fund – World Economic Outlook 2007
2. IMF's freshly released World Economic Outlook for latest global economic trends
3. www.globalconditions.worldpress.com
4. www.ris.org, India's Rising Role in Asia, RIS discussion paper, Mukul G. Asher, March 2007
5. Korean business organisation KOTRA (Korean Trade Centre) set up the Korean week in Mumbai to promote bilateral trade and investment between the two countries and increase trade from the existing USD 6.7 billion to USD 10 billion by 2010 (Business Standard, November 22,2006)
6. See UNCTAD's Least Developed Countries Report (2004a) for a qualified discussion
7. Communication has become faster due to fax, mobile, internet, satellite and major events are known in minutes
8. http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_129970.pdf, where do the benefits of Doha Development Agenda (DDA) trade liberalization come from? – Brussels, 3 April 2006, p.2
9. Subsidies to the agricultural sector in the OECD Countries alone exceed $300 billion. Horst Kohler, The Economic Times, November 15, 2002
10. On Tuesday morning, September 11, 2001, the United State is attacked by terrorists in New York City and Washington. Four U.S. planes hijacked by terrorists crashed into the World Trade Center, the Pentagon and a field in Pennsylvania killing nearly 3,000 people in a matter of hours

11. UNCTAD, Trade and Development Report, 2002, p.19
12. UNCTAD, Trade and Development Report, 2002, p.17
13. Terms of Trade is the ratio of a country's export and import prices and provides an important indicator of the benefits the country is deriving from international trade
14. “Coping with Terms-of-Trade Shocks in Developing Countries” by Christian Broda and Cédric Tille, Current Issues in Economics and Finance, Federal Reserve Bank of New York, Vol. 9, No. 11, November 2003
15. WTO focus, March, April, 2001
16. Increasing the stock of available technology is critical to development, because technology plays a central role in boosting output per worker and is an important determinant of income levels. See WTO (2002) for a discussion
17. http://www.wto.org/english/forums_e/ngo_e/posp48ifsl_e.pdf
18. Rodrik, Dani (2000b), *Comments on* “Trade, Growth, and Poverty, by D. Dollar and A. Kraay”, Stockholm, World Bank and Globkom Conference on Poverty and the International Economy, October 20-21
19. The General Secretary of the International Confederation of Trade Unions, quoted in the International Herald Tribune, and World Bank Development News, December 21, 2000
20. Winters, Alan (2000), Should Concerns About the Poor Stop Trade Liberalisation?, Paris, Annual World Bank Conference on Development Economics, June
21. Devarajan, Shantayanan and Dominique van der Mensbrugghe (2000), Trade Reform in South Africa: Impacts on Households, Stockholm, World Bank and Globkom Conference on Poverty and the International Economy, October 20-21

22. Rodriguez, Francisco and Dani Rodrik (1999), Trade Policy and Economic Growth: A Skeptic's Guide to Cross-National Evidence, Cambridge MA, NBER working paper n°7081

23. The General Secretary of the International Confederation of Trade Unions, quoted in the International Herald Tribune, and World Bank Development News, December 21, 2000

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