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Research Article

Trade Liberalization: Is it a Useful Program for Agricultural and Manufacturing Sectors in Developing Countries?

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ABSTRACT

The authors investigated whether trade liberalization is a useful programme for agricultural and manufacturing sectors in the developing countries. A historical approach was used to measure impact. There are mixed results regarding the impact of trade liberalization. The results which show negative impact are generalized without being very exact the nature of impact. The results which show positive impact of trade liberalization have generally based their evidence on real GDP and per capita income growth rates while ignoring other factors which contribute to their growth. Two schools of thought have emerged namely pro-trade liberalization and those against trade liberalization. Indicators are purposely chosen and the results support that school of thought. It is recommended that studies of trade liberalization use a number of indicators to measure impact. That studies should be able to isolate other influences on the indicator before making conclusions. There is a need to come up with uniform indicators to measure impact. A developing country should initiate a comprehensive study of its economy before entering zero tariff agreement with developed country. Developing countries should attract transnational corporations to improve efficiency. Policies which encourage redistribution of incomes should be introduced.

Keywords: Trade liberalization, trade openness, structural adjustment.

INTRODUCTION

Developing countries have been the major implementers of trade liberalization programmes. This is the case because trade liberalization has most often been packaged together with structural adjustment programmes. Those countries which have mismanaged their economies and have approached the Bretton Woods institutions often have been prescribed this route. Developing countries are defined by the World Bank as nations with an annual gross national product (GNP) per capita amounting to US$9075 or less. According to Easterly and Schmidt-Hebbel (1993) macroeconomic indicators of most of the developing countries are not too good. The incidences of poverty are very common in developing countries than in the developed countries. Trade liberalization is justified on the basis that it creates opportunities for the firms to expand through improved access to new production innovations, inputs and managerial know how. That competition brought about by imports is healthy and leads to specialization and efficient allocation of resources by weeding out entities that are burdensome to the society. However, gains from trade liberalization are not so obvious but require proper management of liberalization programme as well as a mechanism to share the gains (Tekere, 2001). The objective of this paper is to assess whether trade liberalization programmes have been useful and have benefited the developing nations.

Trade liberalization is part of the Structural Adjustment Programmes (SAPs) (Anandajayasekeram et al., 2012). Structural Adjustment Programmes can be traced from Europe during post-World War II period. The theory was further improved in Latin America. The proponents of the theory believed that there was rigidity in the economic system as such change could not take place due to structural rigidities. The rigidities included import concentration and limited purchasing power of exports (Mwanza, 1992). According to Olukoshi and Nwoke (1994), SAPSs were initiated by Monetarist School at the time Keynesianism’s influence was declining and the eventual collapse of the
Bretton Woods systems. The Monetarists were of the view that inflation was the main problem that national economies and the world economy were facing. The Keynesianisms however, were of the view that unemployment was a major problem that nations face. In the end, the Bretton Woods institutions, World Bank and International Monetary Fund embraced the Structuralist theory and abandoned Keynesianism. Then they began to prescribe to those countries which approached them for support to correct economic mismanagement.

Under the Uruguay agreements, nations are supposed to get rid of trade barriers in order to meet their target to liberalize trade. Trade liberalization targets much more the developing nations as opposed to developed nations. Most of these impediments are in the form of non-tariff barriers mainly intellectual property rights, labour standards, health and sanitary requirements as well as environmental (Mahdi, 2009). However, according to Madeley (2000), the IMF/World Bank initiated Structural Adjustment Programmes (SAPs) which started in 1980 have caused implementation of trade liberalization programmes in most developing nations well before the signing of World Trade Organization agreement. Trade liberalization involves the removal of quantitative barriers and reduction in import duty. It provides increased export incentives while exercising some import restrictions. This is the broader definition of trade liberalization. The narrow definition of trade liberalization involves the use of a currency devaluation to stimulate exports and improve trade balance without utilizing tariffs due to relative price effect (Jebuni et al., 1994). Trade liberalization increases the welfare of consumers and reduces poverty because consumers are in a position to choose from cheaper imports (Tekere, 2001).

According to the Organization for Economic Co-operation and Development (OECD) (2005), liberal trade and investment policies which spearhead structural adjustment through influencing growth, innovation and competitiveness and are implemented over time allow the affected to adjust quickly in order to avoid a policy from reverting to pre-liberalization (policy reversal). Measures which tend to avoid trade liberalization through resistance to implementation have a tendency of slowing down adjustment. Those who criticize the conventional trade theory have said that trading environment is not fair to everyone due to uneven exchange, transfer pricing and price imperfection (Lall, 1998).

Domestic market liberalization involves removal of price and exchange rate distortions and has major impact on the poor people. This occurs due to the fact that when subsidies are removed, they are removed from the products which are accessed by poor people for example foodstuff. It also includes the removal of subsidies from the services utilized by the poor people. Such goods and services constitute a bigger percentage of their purchase basket. Further labour market changes have the ability to hurt the position of workers through the removal of minimum wage. Adjustment made in the legislation as regards to recruiting and dismissal which becomes very easy has the ability to weaken trade unions and their bargaining power (Melville, 2002).

Policies which have been implemented under trade liberalization have so far put a lot of pressure on local firms in developing nations mainly because of the removal of government assistance and subsidies. Small and medium agricultural firms have been the most vulnerable ones. Trade liberalization programmes were intended to benefit and have positive impact on developing countries across the globe. However, this has failed instead there has been negative effects (Mahdi, 2009). Trade liberalization policies have major negative impacts on areas which have tremendous achievements for social programmes (Steward & Berry, 2001).

METHODOLOGY

The authors have used historical approach through survey of previous studies to reach their conclusions. The historical approach is used in all fields of study and it uses both quantitative and qualitative variables. It uses the information that already exists on the subjects and includes: origins, growth, theories and findings of the previous studies (University of Texas, 2013). The authors noted that most of the previous studies relate to a particular country or a group of countries not specifically in the context of developing countries which this study fulfils. Mzumara (2012) used this method in analyzing the causes of conflict in Zimbabwe.

RESULTS

The study done by Thomas (1999) in India found that due to huge import of edible oil during 1998-99 under the implementation of trade liberalization led to falling of prices on the local market of domestically produced edible oil. The measures drove the local producers out of business. This action led India into becoming the world’s largest net importer of edible oil. In another study done by Sharma (1999) found that there were complications that arose from intensive farming in India worsened due to impact of trade liberalization. In respect of milk, India has become the dumping arena for international producers. Although India is the world’s largest producer, however, cheap imports
have threatened the livelihoods of over a million small producers of milk. In line with the requirements of WTO, India is trying hard to open up its domestic to international trade even to an extent of eliminating import restrictions an ingredient of a disaster. In the study conducted by Madeley (2000), it was found that liberalization has forced the prices of inputs to increase beyond the reach of small scale farmers in India.

In a study done by Philippine Peasant Institute (1998) in Philippine, farmers’ share of domestic market declined due to influx of imported goods under implementation of trade liberalization. According to another study done by Philippine Peasant Institute (1999), the government in Philippine supported free markets that they offer the best way for having food security that trade liberalization would assist local consumption which would be achieved through cheap imports from abroad. In addition, the elimination of local trade barriers was seen as would help the Philippines to enjoy the gains of comparative advantage and would lead to higher domestic economic performance by reducing opportunistic activities. However, the small farmers were against trade liberalization as it would lead to the reduction in the production of agricultural commodities and lead to declined income. In a study done by Madeley (2000), countries such as Philippines are affected by influx of cheap imports when undergoing trade liberalization. The imports were cited as originating from the United States of America and the European Union representing the developed countries. Philippines was also flooded with products from fellow developing countries for example, it imported cheap sugar from Thailand. It thus led to domestic producers going bankruptcy. The findings of Madeley (2000) study and conclusions go against the theory of comparative advantage. The theory either in its original form or taking into account the extension made by Heckscher-Ohlin that a country should specialize in the products in which comparative advantage exist. If the Thailand sugar is cheaper, then Thailand has comparative advantage over the Philippines and it will be well for the Philippines to channel those resources into other areas in which it has comparative advantage.

In a study done by Eurostep (1999), the European Union had agreed to exclude 45% of South Africa’s agricultural exports which were equivalent to 6% of South Africa’s total exports to the European Union. The 45% included products in which South Africa posses’ significant comparative advantage such as wine, oranges, pears, apples and cut flowers. In the negotiations, the European Union agreed for complete liberalization for South Africa’s industrial goods without imposition of any restrictions on quantity and a limited reduction of the 45% of the initial agricultural goods the European Union had earlier on agreed to. Most importantly, the European Union proposed zero tariff quotas on products like wine, cut flowers, cheese and curd while reduced duty quotas on cut flowers, canned fruits and fruit juice and limited liberalization on value added agricultural goods. The study assessment was that when agricultural sectors are added is the only way South Africa gains from trade liberalization with the European Union. The study concluded that South Africa – European Union Agreement only favours the European Union with very little gains accruing to South Africa. Most of agreements between developed countries and developing countries tend to favour developed countries unless they give substantial concessions to developing countries without the requirement of reciprocity. So it is not surprising that the European Union is benefiting much more than South Africa.

According to the study done by Oxfam (1996), the proponents of Uruguay Round Agreement have shown that benefits from trade liberalization comes from improvement in efficiency as well as increasing of national wealth; however, they conceded that the gains would not be equitably shared. The study concluded that there are losers under trade liberalization and in most cases are poor people. However according to the theory of comparative trade without restrictions leads to efficient allocation of resources. The findings of Oxfam go against the theory in that there are always going to be losers as well as the winners suggesting no mutual gains arising from free trade.

In a study conducted by Friend of the Earth Uruguay (1999), Uruguay has been negatively impacted by cheap imports from countries e.g. Spain. The products which have caused havoc include Asian peas, Greek processed peaches and Dutch potatoes. Other cheap imports which have negatively affected Uruguay come from MERCOSUR region. The products include lettuce, red peppers, sweet maize, lentils, apples, grapes and carrots. The study lacks clarity whether Uruguay has comparative advantage or not in the said cheap products. If there is no evidence of dumping, it would mean that Uruguay has no comparative advantage in their production and if it is producing might be doing so inefficiently.

In a World Bank (2000), study rice price adjustment influenced by trade liberalization led to welfare losses estimated at 20% for a third of rice farmers in Madagascar. Such farmers are amongst the poor people of Madagascar. The study however, did not look at the side of consumers who benefited from lower prices.

According to the study done by Geda (1999), trade liberalization which was part of Ethiopia’s structural adjustment policy led to substantial increase in exports both in volume and value. There was also an increase in the value under coffee farming and the private sector was part of processing and marketing. However, trade liberalization did not reveal increased competitiveness of Ethiopia on the world market as its share remained small to have any impact. Its share being only 2%. The quantity of coffee exports, processing and agricultural income is to larger extent influenced by domestic and external trade policies. The findings of the study are consistent with theory of
comparative advantage that free trade would lead to substantial gains as countries specialize in the products in which they have comparative advantage.

In a study done by Chisvo (2000), trade liberalization in Zimbabwe was carried out as part of the International Monetary Fund (IMF)/World Bank Economic Structural Adjustment Programme (ESAP). The effects of trade liberalization were more on the negative side than positive. The negative impacts of trade liberalization mainly occurred due to removal of subsidies and increase in the cost to produce. Zimbabwe was supposed to remove import and export subsidies and replace them with direct income transfer and reduction of import duty. However, not much was implemented by Zimbabwe. The study does not however, shed light in which areas that experienced negative impacts. However, Thomas and Nash (1991) concur that Zimbabwe had implemented mild reforms. According to the study done by Tekere (2001), trade liberalization in Zimbabwe led to opportunities for small scale producers to venture into cash crops such as cotton. Trade liberalization resulted in the coming in of small scale private producers who were agents and processors. He however laments to policy reversal as being very frequent and failure on the part of the government to provide announced incentives led to the failure of the programme. The government abandoned the programme and began to implement trade liberalization under the Southern African Development Community (SADC). Tekere’s study did not weigh whether gains outweighed the cost of liberalization. According to Parsons (2007), ESAP in Zimbabwe failed and resulted in job insecurity. This study gives the overall failure of ESAP rather than trade liberalization in particular.

According to Watkins (1997), trade liberalization in Mexico brought both opportunities and threats in different parts of the country as well as on social groups. For those with resources managed to acquire factories under privatization. They also purchased land. Jobs were created however, in other parts there were losses of livelihoods by many. However the study failed to quantify the gains and losses.

In Zambia, the study done by Seshamani (1999), Zambia implemented a full scale structural adjustment programme and within two years it eliminated subsidies on food stuff as well as farm inputs, introduced market prices, liberalization of interest rates, liberalization of trade and foreign exchange market and cost recovery in education and health services. The introduction of trade liberalization only led to immediate negative impact on the economy and welfare of Zambians. The study failed to disclose what role structural adjustment played overall or whether there was a basis to attribute these short comings on trade liberalization alone. According to Thomas and Nash (1991) disagrees with Seshamani that Zambia liberalized in full instead contends that it carried out mild liberalization.

According to the study done by Jones (1997), trade liberalization was implemented in Sierra Leone as part of the Structural Adjustment Programme (SAP). Exports were encouraged through the removal of export duty. Rice production has been on the downward trend in production mainly due to influx in cheap imported rice which has pushed domestic production to decrease due to inability to compete with imported rice. It is not clear what can be attributed to the overall failure of SAP or the aspect caused by trade liberalization specifically.

In a study conducted by Nyangito (1999), trade liberalization in Kenya in products led to influx of food imports specifically maize, wheat, rice, sugar and dairy products. Cheap imports from abroad led to depressed producer prices and stiff competition for local suppliers thereby leading to reduction in local production. In another study conducted in Kenya again by Wauye (2007) found that due to trade liberalization there was a surge in sugar import in 1992, 1994, 1999 and in 2002 thereby destroying the local sugar industry which was unable to compete with this cheap imports. Barring from dumping, the studies do not disclose whether Kenya poses comparative advantage in the said products.

According to Vendeseilanden (1998) study, trade liberalization in Uganda was responsible for a decline in the productivity owing to limited access to farm in puts and distortion in the domestic market. These results however differ with those of Collier and Reinikka (2001) where trade liberalization is credited to have enabled the Ugandan economy to recover during post-conflict reconstruction. In fact, Uganda and Mozambique are considered success stories in post-conflict reconstruction due to their implementation of trade liberalization. In Uganda, coffee exports surged due to the implementation of trade liberalization. Coffee proceeds were invested in non-exporting sectors thereby leading to total recovery of Uganda. It is not clear why the two studies on the same country would produce two different results on the impact of trade liberalization.

In a study conducted by Murphy (1999) found that Bangladesh was a beneficiary of trade preferences schemes. The advent of trade liberalization has eroded the gains that Bangladesh was benefitting. Bangladesh has found not much advantage in liberalizing its economy. The question here is not much on trade liberalization but rather on the principle of reciprocity to have caused the loss of benefits.

According to the study done by Anwar (2002) in Pakistan, trade liberalization was effectively implemented. However, it led to a greater height of incidences of poverty. Farmers were declared bankruptcy as they failed to compete when Pakistan opened up its economy. This study differs with Thomas and Nash (1991) who puts Pakistan
to have moderately implemented trade liberalization. Further Pakistan was able to reduced its budget deficit as well as inflation.

In study done by Dollar and Kraay (2001) trade liberalization increased per capita income growth in 18 countries between 1980-1984 and between 1995-1997 periods. The notable ones with the highest per capita growth are Argentina (8.4%); China (3.9); Dominican Republic (7.7%); Mexico (6.5%) and the Philippines (6.2%). In the 1990s a big number of developing countries had opened up and their economies started growing quicker that developed nations. Countries which had opened up saw their growth rates increased faster between 1980s and 1990s. The income of the poor people increased rapidly than average in Malaysia and Thailand. Thailand had the fastest growth rate of its income of its poor at an average rate of 4.7% between1980 to 1990. In China the income of the poor people has remained behind the growth per capita GDP of China. Income inequality has declined in Malaysia, the Philippines and Thailand. The problem with the findings of Dollar and Kraay is their inability to isolate growth arising from other policies other than trade liberalization. By simple calculation of growth rates and comparing them between periods of implementation of trade liberalization is to overstate the impact without isolating other variables at play during the same period e.g. other policies that governments would be carrying out in tandem with trade liberalization. Definitely, it is naive to advance arguments based on factors which could have been caused by a host of variables.

According to Thomas and Nash (1991) study found that countries which had substantially liberalized (Chile, Columbia, Ghana, Jamaica, Korea, Mauritius, Mexico and Turkey) and those countries which had carried out moderate liberalization (Bangladesh, Madagascar, Morocco, Pakistan, Panama, Philippines and Thailand) were able to reduce inflation, fiscal deficits. Those countries which carried out mild liberalization (Cote d’Ivoire, Guyana, Kenya, Malawi, Senegal, Togo, Yugoslavia, Zambia and Zimbabwe) experienced large budget deficits and very high inflations at the conclusion of their reform periods. The major short coming of this study is that the authors examined very narrow variables when they made their conclusions in support of trade liberalization. It is common knowledge that countries which reduce budget deficits will likely experience very low inflation and those that have high budget deficits will likely have high inflation. Budget deficits can arise not necessarily through provision of subsidies but a country may be at war or may be involved in a war in neighbouring countries like several African countries were entangled in Democratic Republic Congo war. Their mild liberalization programme may not be the reason for their persistent budget deficits. The study is not advancing anything of concrete.

Motusz and Tarr (1999) study found that adjustments costs were very little as compared to the gains arising from trade liberalization. However, Matusz and Tarr based their conclusions on studies done in developed countries which are very much aided by technology to make a smooth and costless adjustment as opposed to developing countries whose adjustment costs may be higher than benefit accruing from opening up.

According to the study done by Greenaway et al (2001) trade liberalization had positive impact on real GDP per capita. This study still has shortcomings like other studies of being unable to show how much was contributed by trade liberalization and then how much was contributed by other policies related to production which are not necessarily under trade liberalization.

In study done by Olayiwola and Raitaiwa (2010) it was concluded that trade liberalization leads to few jobs increases in the textile and clothing sector in Tanzania. The study failed to isolate the effects of the SAP in general from its component in this case trade liberalization.

CONCLUSIONS AND RECOMMENDATIONS

There are mixed results regarding the impact of trade liberalization in developing countries in the agricultural and manufacturing sectors. The results which show negative impact have generalized the impact without being very exact of the nature of impact. The results that show positive impact of trade liberalization have generally based their evidences on real GDP and per capita income growth rates while ignoring other factors which contributed to their growth. Two schools of thoughts have emerged. The pro–trade liberalization tend to pick one or two indicators to prove that trade liberalization is beneficial. However, the one or two indicators are just few of many indicators which need to be looked at before conclusions are made. Then those against trade liberalization tend to generalize how the poor are affected without clearly assessing the gains for the rest of the economy. Indicators are clearly chosen to highlight the school of thought and results clearly support that thought.

It is recommended that studies on impact of trade liberalization use a number of indicators to measure impact. Further studies should be able to isolate other influences on the indicator before making conclusions. There is also a need to come up with uniform indicators to measure impact. A developing country should initiate a comprehensive study of their economies before they enter into any agreement especially the zero tariff agreements with more developed and sophisticated economies. Developing countries should attract foreign direct investment.
through transnational corporations to improve on efficiency in production which will result in competing effectively with cheap import abroad. Policies which encourage redistribution of incomes should be encouraged in order to reduce inequalities.

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