CHAPTER 7

Trade Liberalization by Developing Countries

7.1. Relevance of the Scenario

The case for liberalization and removal of protection is in some senses stronger, and in others weaker, for the developing countries. The increased efficiency of allocation to which liberalization leads should be especially important for a poor country. The directly unproductive rent-seeking activities that are encouraged by distortionary protective policies waste real resources, including entrepreneurial talents, which are particularly scarce in developing countries.

The value of increased competition in domestic markets, which improves the quality and efficiency of production, can be substantial for poor countries. Though outward orientation makes a country more vulnerable to external shocks, Srinivasan (1986) has argued, on the basis of the post-oil-shock experience of developing countries (Balassa, 1981a, 1983a,b), that outward orientation seems to increase a country's capacity to absorb and adjust to these shocks as well.

On the other hand, many of the arguments for protection are also of greater relevance for the developing countries. These include protection of infant industry to permit learning by doing; optimal or scientific tariffs on exports since many developing countries exporting primary commodities hold market power as major exporters facing often inelastic demands; noneconomic objectives such as special emphasis on the nutritional status of the poor; industrialization; attainment of self-sufficiency, not only for political reasons but also for providing income to the poor who depend on agriculture (Baldwin, 1952; Caves and Jones, 1973; Johnson, 1953–1954, 1960, 1968).

Notwithstanding the argument for protection, however, many developing countries, facing balance-of-payments problems, are advised by the IMF and the World Bank to liberalize. Whereas the IMF and the World Bank advocate liberalization by all countries, they have relatively little clout with the developed

countries to make them liberalize trade. Thus, even though some of the gains from trade liberalization mentioned above cannot be captured using the BLS, it is of considerable policy relevance to examine the impact of trade liberalization by the developing countries alone. Developing countries are often given supplemental aid in the form of additional loans, sometimes at concessional terms, by the IMF and the World Bank to help them adjust to liberalization. The results of a scenario of trade liberalization by developing countries can provide indications as to the wisdom of liberalization or the adequacy of such aid.

Thus, in this chapter, the outcome of trade liberalization by developing countries alone is described. The results are analyzed primarily in terms of gains and losses for the different countries, with a particular emphasis on welfare in developing countries.

7.2. The Specification of the Scenario

Once again it should be emphasized that only those protection (positive or negative) measures are removed that are captured in the calculated tariff equivalents. Thus, only border distortions are removed. As was discussed in Chapter 3, these include tariff equivalents (positive or negative), quotas, and subsidies for domestic transport of exports. Other distortions, introduced through subsidy or taxes on factor and input prices, production quotas, consumer subsidies of many kinds, etc., are not removed. Whereas one may argue that such nonborder distortions are not significant for agricultural commodities in developed market economies (except for the land set-aside program in the USA, which is also removed in the various trade liberalization scenarios in which the USA liberalizes), one cannot say this for developing economies. Yet systematic data on such distortions are not easily available, and in this scenario these distortions are not removed. One may add here that these distortions are not explicitly modeled in the national models of the BLS, but are only implicitly accounted for in the estimated parameters of the system. Thus, it would have been difficult to remove such distortions, even if data were available on them.

This scenario is designated by F-LDC. Though all developing countries liberalize trade, China does not do so. Also, as in other scenarios, liberalization is carried out over five years from 1981 through 1985 so that 1986 is the first year when trade is fully liberalized.

7.3. Impact on the World Market

Agricultural trade liberalization by the developing countries triggers in this scenario the changes in the world market prices. However, these changes in turn also determine the way the different national economies react and develop over time.