

Miracles and Debacles: Do Free-Trade Skeptics have a Case?

Arvind Panagariya
Columbia University

<http://www.Columbia.Edu/ap2231/>

Federal Reserve Bank of Dallas
Nov. 3-5, 2004

The Case for Trade Openness

- Trade openness is necessary for sustained rapid growth
- Trade openness is not the cause of stagnation or decline
- When pushed to choose between trade openness and protectionism, critics actually choose openness.

Qualification: Openness can bring adjustment costs and hurt specific groups but the remedy is direct corrective action.

But first a few non-sequiturs

- Many countries that opened to trade failed to achieve a jump in the growth rate
- Many successful growth experiences were catalyzed by alternative policies
- Many countries have grown rapidly behind a high wall of protection
- Increased protection has stimulated growth in many cases
- Industrial policy has worked in many countries

3

A Tale of Two Countries: South Korea and India, 1960-80

- Rodrik (1995): Korea grew rapidly because it "managed to engineer a significant increase in the private return to capital" by "subsidizing and coordinating investment decisions." New investments required imported machinery, which necessitated exports.
- Exports grew 23.7% annually 1961-80; exports/GDP ratio rose from 5.3% in 1961 to 33.1% in 1980.
- Westphal & Kim (1982): "Export expansion was directly responsible for more than one quarter of the growth of manufactured output" between 1961 and 1975.
- Westphal (JEP 1990): "Industrial Policy in an Export-Propelled Economy: Lessons from South Korea's Experience."

4

But Grant Rodrik his Investment Coordination Story and Ask...

- What would have happened if Korea had pushed import-substitution further and chosen to produce the needed machinery at home?
- India provides the answer since that is exactly what it did during the 1960s and 1970s
- In India, imports (other than oil and cereals) fell from 7 percent of GDP in 1957-58 to 3 percent in 1975-76.
- Per-capita income growth during 1961-80 was 1.1% in India and 6.3% in Korea.

5

Korea is not an Exception: Miracles and Debacles

- Miracles: Countries with per-capita income growth rates of 3 percent or more
- Debacles: Countries with negative per-capita income growth rates

Question: What role has trade played in miracles and Debacles?

Answer: Based on data availability, consider two time periods, each spanning 19 years:

1961-1980 and 1980-1999.

6

Table 1: Miracles of 1961-80*

Country	Growth Rates			Population in Million (1961)
	GDP per capita	Exports	Imports	
Botswana	8.5			0.5
Malta	7.3			0.3
Singapore	7.2			1.5
Hong Kong,	6.9	10.8	10.6	3.2
Gabon	6.6	10.6	12.1	0.5
Taiwan, China	6.4			11.0
Korea, Rep.	6.3	23.7	18.0	25.7
Lesotho	4.8	7.6	11.8	0.9
Trinidad and	4.7	3.8	9.1	0.9
Thailand	4.6	9.3	9.6	27.2
Brazil	4.6	8.1	7.6	75.0

7

Miracles of 1961-80: Continued

Malaysia	4.4	6.9	7.2	8.4
Barbados	4.4			0.2
Israel	4.2	10.8	8.1	2.2
Georgia	4.1			4.2
Cote d'Ivoire	4.1	7.6	7.9	3.9
Seychelles	4.0			0.0
Tunisia	4.0	8.3	7.2	4.3
Bermuda	4.0			0.0
Ecuador	3.7	8.2	8.0	4.6
Dominican	3.6	5.6	10.6	3.3
Ireland	3.6	8.0	7.8	2.8
Egypt, Arab Rep.	3.5	5.4	8.1	26.5
Indonesia	3.5	6.5	10.2	95.9

8

Miracles of 1960-81: Continued

Paraguay	3.5	3.0	10.6	1.9
Mauritius	3.5	2.4	3.8	0.7
Mexico	3.4	8.6	7.8	38.1
Panama	3.4			1.2
Belize	3.4			0.1
Togo	3.2	9.9	8.8	1.5
Fiji	3.0	7.6	7.7	0.4
Mauritania	3.0	11.3	7.7	1.0
Kenya	3.0	3.3	3.6	8.6

*Non-oil-exporting developing countries with per-capita GDP growth rate of 3 percent or more (33 countries with a combined population of 356.5 million people in 1961).

9

Table 2: Debacles of 1961-81*

		Growth Rates			Population in Million (1961)
		GDP per capita			
Country		capita	Exports	Imports	
Central African		-0.1			1.6
Zambia		-0.3	1.0	0.4	3.2
Somalia		-0.4			2.9
Madagascar		-0.4	1.2	1.8	5.5
Dominica		-0.4			0.1
Ghana		-0.4	-2.7	-3.0	7.1
Guinea-Bissau		-0.5			0.5
Niger		-0.5	3.5	7.8	3.1
Senegal		-0.6	-0.1	1.2	3.3
Iran, Islamic Rep.		-0.7			22.1
Congo, Dem. Rep.		-0.9	2.8	5.7	15.7
United Arab		-1.0			0.1
Chad		-1.9	1.4	0.8	3.1
Kuwait		-3.6			0.3

*All developing countries with negative growth rates (14 countries with a total population of 68.6 million). Exports and imports include goods and services and are measured at constant prices.

10

Table 3: Miracles of 1980-99*

Country	Growth Rates			Population in Million (1980)
	GDP per capita	Exports	Imports	
China	8.3	10.4	8.0	981.2
Korea, Rep.	6.6	12.9	10.5	38.1
Equatorial Guinea	6.4			0.2
Taiwan, China	6.1			17.6
Singapore	5.9			2.3
St. Kitts and Nevis	5.9	2.9	2.9	0.0
Thailand	5.5	11.9	8.0	46.7
Indonesia	4.7	2.6	3.7	148.3
Botswana	4.7			0.9
Hong Kong, China	4.5	11.0	10.8	5.0
Antigua and Barbuda	4.4	5.4	4.8	0.1

11

Miracles of 1980-99 Continued

Dominica	4.2	9.1	1.8	0.1
Bhutan	4.1			0.5
Malta	4.1			0.4
Chile	3.9	7.7	5.5	11.1
Malaysia	3.9	11.1	9.6	13.8
India	3.8	8.5	6.5	687.3
St. Vincent and the	3.7	4.4	2.6	0.1
St. Lucia	3.7	4.0	3.1	0.1
Mauritius	3.7	7.4	6.8	1.0
Grenada	3.4	6.0	3.8	0.1
Maldives	3.3			0.2

12

Miracles of 1980-99 Continued

Sri Lanka	3.1	6.0	5.6	14.7
Cape Verde	3.1			0.3
Pakistan	3.0	5.8	1.4	82.7

* Non-oil-exporting developing countries with per-capita GDP growth rate of 3 percent or more (26 countries with combined population of 2106.5 million in 1980). Exports and imports include goods and services and are measured at constant prices.

13

Table 4: Debacles of 1980-99*

Country	Growth Rate			Population in Million (1980)
	GDP per capita	Exports	Imports	
Afghanistan	-0.1			16.0
Gambia, The	-0.1	2.7	-1.1	0.6
Estonia	-0.1			1.5
Guatemala	-0.2	1.5	3.4	6.8
Ecuador	-0.2	4.9	-1.7	8.0
Samoa	-0.2			0.2
Namibia	-0.2	2.5	2.6	1.0
El Salvador	-0.3	3.6	5.7	4.6
Latvia	-0.3			2.5

14

Debacles of 1980-99 Continued

Gabon	-0.3	2.8	0.1	0.7
South Africa	-0.4	2.9	2.5	27.6
Honduras	-0.5	0.8	1.6	3.6
Bolivia	-0.5	2.7	4.3	5.4
Netherlands	-0.5			0.2
Croatia	-0.5			4.6
Togo	-0.5	-0.8	0.0	2.6
Yemen, Rep.	-0.6			8.5
Sao Tome and	-0.6			0.1
Rwanda	-0.7	-1.0	5.5	5.2
Albania	-0.7			2.7
Algeria	-0.7	3.5	-2.1	18.7
Suriname	-0.7	-5.6	-6.4	0.4
Cameroon	-0.7	4.8	4.0	8.7

15

Debacles of 1980-99 Continued

Romania	-0.8			22.2
Mali	-0.9	6.9	4.0	6.6
Somalia	-0.9			5.9
Nigeria	-0.9	0.0	-3.0	71.1
Vanuatu	-0.9			0.1
Comoros	-1.0	11.3	0.1	0.3
Lithuania	-1.0			3.4
Micronesia, Fed.	-1.0			0.1
Belarus	-1.0			9.6
Russian Federation	-1.1			139.0
Bahrain	-1.1			0.3
Burundi	-1.2	7.7	2.6	4.1
Venezuela, RB	-1.2	3.3	2.1	15.1
Uzbekistan	-1.2			16.0

16

Debacles of 1980-99 Continued

Central African	-1.3			2.3
Angola	-1.4			7.0
Kuwait	-1.5			1.4
Zambia	-1.6	-0.1	-2.3	5.7
Djibouti	-1.6			0.3
Madagascar	-1.9	0.8	-1.9	8.9
Nicaragua	-1.9	2.7	3.2	2.9
Kyrgyz Republic	-1.9			3.6
Cote d'Ivoire	-1.9	2.9	0.1	8.2
Liberia	-2.0			1.9
Marshall Islands	-2.1			0.0
Armenia	-2.2			3.1
Haiti	-2.2	2.7	5.6	5.4
United Arab	-2.4			1.0
Kiribati	-2.4			0.1

17

Debacles of 1980-99 Continued

Kazakhstan	-2.5			14.9
Saudi Arabia	-2.6			9.4
Niger	-2.6	0.1	-5.1	5.6
Brunei	-2.8			0.2
Sierra Leone	-2.9	-4.8	-5.2	3.2
Moldova	-3.6			4.0
Tajikistan	-4.1			4.0
Ukraine	-4.3			50.0
Libya	-4.5			3.0
Congo, Dem. Rep.	-4.5			27.0
Georgia	-4.7			5.1
Azerbaijan	-5.1			6.2
Iraq	-9.5			13.0

*Developing and Transition economies with negative growth rates (65 countries with combined population of 621.4 million). Exports and imports include goods and services and are measured at constant prices.

18

Salient Features of Miracles and debacles

- Miracles are almost always associated with fast growth in exports and imports
- Debacles are rarely accompanied by import surges
- Many more miracle countries during 1961-80 than 1980-99 but many more beneficiaries of miracles during the latter period
- Many more debacle countries and many more sufferers during 1980-99 than 1961-80.

19

The Econometric Evidence is not as Weak as Critics Assert



- Cross-country studies: Romain Wacziarg and Karen Welch (2002) construct a panel data set that allows them to exploit within and between country variations. They find that on average, a country grows at 1.5 percent per annum higher rate in the liberalized phase than in the protected phase, controlling for country and year effects.
- The firm-level studies. For example, the recent study on India by Jagdeesh Sivadasan (2003) based on a panel of 40,000 plants spanning 1986-87 to 1994-95. Sivadasan finds a 30 to 35 percent increase in mean intraplant productivity in those industries subject to tariff liberalization. He also finds a 25 percent increase in aggregate output growth and a 20 percent increase in aggregate productivity growth following tariff liberalization.

20

Trade Volumes versus Trade barriers

Critics: Trade barriers do not correlate with growth and trade volumes are endogenous.

Answer:

-  Do we believe in trade barriers impacting trade volumes?
-  Difficulty in devising measures that reflect accurately the protective effect of a given set of trade barriers

21

Is Latin America an Exception

- The role of debt, capital-flow crises and macroeconomic instability
- The Case of Brazil
 - 1968-73: period of trade liberalization (tariffs on manufactures and agriculture cut by nearly 40 percent and the real exchange rate overvaluation corrected)
 - 1974-80: Period of renewed inward-looking policies
 - Export growth: 4.2 during 1961-68, 11.7 during 1967-75 and 8.6 during 1975-80.

22

Brazil: Growth Rates of per-capita GDP

<i>1962</i>	<i>7.1</i>	<i>1969</i>	<i>8.6</i>	<i>1976</i>	<i>2.8</i>
1963	2.1	1970	7.0	1977	7.2
1964	-2.1	1971	6.1	1978	2.2
1965	0.5	1972	8.7	1979	0.8
1966	0.2	1973	9.4	1980	4.3
1967	1.4	1974	11.4	Average	3.5
1968	2.2	1975	6.5		
Average	1.6	Average	8.3		

23

Latin America: The More Recent Case of Chile

- Chile's GDP grew at the annual rates of 5.3 and 5.9 percent respectively during 1981-91 and 1991-01.
- During the same time periods, its exports of goods and services grew annually at 8.6 and 9 percent, respectively with the imports to GDP ratio rising from 26.8 percent in 1981 to 32.7 percent in 2001
- Sound macroeconomic management

24

More Country-specific Evidence

Two large-scale projects

- OECD: Little Scitovsky and Scott (1970)
- NBER: Bhagwati-Krueger (1974)

Stellar performance during 1960s by
Hong Kong, Singapore, Korea, Taiwan
Poor performance by India

25

China:1980-2000

- Opening up starting 1978
- Double digit growth during 1980-2000 with per-capita incomes more than quadrupling
- Exports of goods and services grew 13 percent during 1980s and 15 percent during 1990s.

26

India: 1980-2000

- Modest liberalization during 1980s
- Deeper liberalization during 1990s
- Growth rate of per-capita income during 1961-80: 1.1 percent
- Growth of per-capita income during 1980-1999: 3.8 percent
- Ratio of trade in goods and services to GDP up from 15 to 30 percent between 1980 and 2000.

27

What do the Free-trade Skeptics Recommend?: Rodriguez and Rodrik

, "The effects of trade liberalization may be on balance beneficial on standard comparative-advantage grounds; the evidence provides no strong reason to dispute this. What we dispute is the view, increasingly common, that integration into the world economy is such a potent force for economic growth that it can effectively substitute for a development strategy." (Rodriguez-Rodrik, 1999)

But virtually all serious advocates of free trade recognize and advocate complementary reform policies. Free trade is only one of the policies in the package.

28

What do the Free-trade Skeptics Recommend?: Joseph Stiglitz

In *Globalization and its Discontents*, Stiglitz explicitly recognizes the importance of liberal trade policies in development. His beef with free trade hovers around two propositions:

- Trade liberalization must be gradual; and
- Rich countries need to do their part by removing trade barriers on products of interest to developing countries, especially agriculture where domestic and export subsidies further undermine the interests of developing countries.

Few serious free trade advocates have any disagreement with these propositions

29

Conclusions

- Trade openness is an essential ingredient in any high-growth recipe (Virtually all growth Miracles have taken place in a liberal or liberalizing trade environment)
- Openness has rarely been responsible for sustained stagnation or decline (Debacles are rarely the result of rapidly rising imports)
- Skeptics have provided no compelling arguments or evidence in favor of their pro-protection stance.

30