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What Should the Framework for Opening up to the International Economy be?

The opening up to the international economy by numerous developing countries is taking place entirely within the framework of regional or international accords. By thus institutionalising their trade liberalisation, these countries are seeking to benefit better from the gains of liberalisation, notably by stressing the irreversibility of the reforms. Nevertheless, this strategy holds out numerous risks, which are especially linked to the uniformity of liberalisation enforced by certain accords. The role of the international trade institutions must undoubtedly be redefined from this point of view, so as to help smaller, poor countries manage liberalisation more effectively and derive the most benefits from it.

Asymmetrical Benefits

Trade liberalisation is today seen as the only viable solution for fostering development. Yet, empirical evidence does not indicate that the greater liberalisation of trade in goods and factors has an indisputably positive impact on growth - contrasting with the "official" (or so-called Washington)[1].. The multidimensional nature of liberalisation and the difficulty of providing a representative variable for it, along with the variety of strategies available, probably partly explains such empirical problems (see Box 1).

This result contrasts strongly with the classical theory of international economics which stresses the optimality of free-trade and the free-circulation of the factors of production. However, it must be pointed out that even if liberalisation can positively affect all the components driving growth (the accumulation of factors and the growth of technical progress), the systematic nature of the gains from trade will disappear as soon as it takes place within a framework of imperfect competition, and this will often be to the detriment of the poorest trade partners. This is not to say that there is no impact on growth, but only that such an impact may not be positive. For example, a small, poor country will have a tendency of specialising in activities of low capital intensity: if such a country is unable to shift to higher quality output, then its incentive to accumulate capital and hence its growth will be lesser[2]. Furthermore, the conditionality of the benefits to growth is now generally accepted: benefits can only be achieved if reforms are implemented and if they are accompanied by the appropriate policies. In an open economy, the "sanctions" incurred by bad policies are more violent. This is the advantage of liberalisation, as it provides strong pressure for reforms to be implemented, though it also constitutes a cost. Hence, as Rodrik[3] has pointed out, liberalisation must be part of a strategy that strives to avoid the pitfalls of bad specialisation dynamics and greater vulnerability to shocks. Instead of being an engine of growth, liberalisation is rather a catalyst[4] that can accelerate growth, but one which is unable to initiate growth by itself.

Such a context raises the question of institutionalising openness, in other words of adhering to global or regional rules. Is this a good way for a developing country to benefit fully from the potential gains of openness? The hope that it is explains why so many countries are members of the WTO or regional free-trade agreements (see Box 2).

1. F. Rodriguez and D. Rodrik, "Trade policy and economic growth: a skeptic's guide to the cross-national evidence", ***NBER Working Paper*** 7081, April 1999.
2. J.L. Guérin, ***Ouverture et croissance***, Doctoral Thesis, University of Paris I, 1999.
3. D. Rodrik, "The new global economy and developing countries: making openness work", ***ODC policy essay*** No 24, 1999.
4. L. Fontagné and J.L. Guérin, "L'ouverture, catalyseur de la croissance", ***Economie internationale***, No 71, 1997.

Box 1 - The Definition and Measures of Openness

Openness is the abolition, or at least reduction, of institutional barriers to trade in goods, services, factors of production and ideas. Participation in international trade (measured for example by the ratio of imports and exports to GDP) is thus an inadequate indicator of openness, which also concerns trade policies and not just trade volumes. Indeed, while trade policies and investment controls of course modify volumes traded, the latter are also affected by other factors (such as size, geographic situation or natural resources). For example, in 1996 this ratio stood at 56% for Algeria, 72% for Sudan, 45% for France, 356% for Singapore and 24% for the United States.

Two methods are used which seek to measure openness. The first consists of calculating the theoretical participation of countries in trade using a model, whereby the ratio of the actual level of participation in trade relative to a theoretical calculation indicates to what extent policies are pro- or anti-openness. The second method involves measuring a country's policy by grading its institutions and policies with respect to trade and investment. Obtaining such grades entails the researcher making discretionary choices (eg: customs duties of more than x% or foreign exchange control mechanisms) or recourse to surveys. The problems with these approaches relate to the fixing of a theoretical level for trade in the first place, and the qualitative or arbitrary nature of the appreciation in the second. Neither method has yet emerged as clearly superior.

The Constraints of Institutionalised Openness

Admission to an international organisation imposes a certain number of constraints, which depend on the organisation. Table I, for example, summarises the obligations which the Central and East European Countries had to fulfil to become members of the WTO and those they will have to meet for entering the European Union.

Up until the beginning of the Uruguay Round in the 1980s, trade negotiations focused essentially on merchandise trade: reductions in customs duties, and the fight against non-tariff barriers. Given the low level of barriers, the trade in goods (excluding agriculture and textiles) mainly runs up against constraints arising from consolidated customs duties, in other words duties countries are committed not to exceed (see Table 2). During the Uruguay negotiations, a very large number of countries committed themselves to consolidated customs duties far above those they actually pursue. As a result, such negotiations do not necessarily lead to greater openness in the short term, but they do prevent a country from increasing its duties too much in the future and from launching trade wars on specific products.

Table 1 - A comparaison of the constraints imposed on countries seeking to join the WTO and the EU

	WTO	European Union
Customs duties	For any tariff level there are 2 constraints: non-discrimination (the Most-Favoured Nation Clause) and a level less than the consolidated tariff	Common External Tariff Zero Internal Tariff
Economic policies	No constraint as long as the WTO accord is accepted	Coordination of certain policies
Standards	Discussions are starting in a number of highly controversial areas	Formulation of numerous codes
Competencies relating to competition policy	Fragmentary	Presence of a real competition policy

The range covered by present accords extends far beyond the simple trade in goods[5]. Yet, recent liberalisation affecting such matters as investment and services - especially telecommunications and financial services - appears to be far more constraining. It requires a modification of social structures and national legislation. Thus, for example, foreign insurers have only been able to acquire more than half the equity of a Malaysian company, since a WTO agreement on financial services in 1997. Similarly, agreements on intellectual property rights or restrictions on investment create stricter norms than are usually practised in developing countries.

These constraints have been reinforced by the emergence of sanctions at the international level. While a country could previously only retaliate by triggering a trade war, the WTO can now order fines to be paid.

Why Institutionalise Openness?

The results expected from institutionalising openness depend, of course, on the type of organisation a country joins and on the specific advantages linked to each accord: in the case of the WTO this means benefiting from the Most-Favoured Nation clause. In all cases, however, it is necessary to send a clear message to foreign investors as well as to domestic pressure groups, in order to eliminate uncertainty and strengthen the credibility of reforms. Thus, WTO membership allows governments of developing countries to emphasise their commitment to the irreversible process of trade liberalisation. Bilateral investment accords are based on the same logic: the herd instinct of foreign direct investment[6] (such investment being a factor supportive of development and stability) encourages countries to multiply the number of positive signals they send out.

Furthermore, in as much as globalisation is seen as inevitable, countries have a stake in participating in the construction of an international system of rules. In contrast to the IMF and the World Bank, votes in the WTO are not weighted according to the economic size of countries. Developing countries can therefore influence decisions: as shown by the recent battle over the

5. The expression "deep integration" is frequently used to describe this phenomenon.
6. The geographic concentration of FDI has been favoured by high capital mobility, risk aversion and lack of information. As a result, in Central and Eastern Europe 70% of FDI between 1993 and 1999 went to Hungry, Poland and the Czech Republic, though these countries only account for 30% of the region's GDP.

Box 2 - Developing Countries in International Organisations

Three types of institutions manage international trade: international trade organisations such as the WTO, regional integration accords and bilateral trade and investment accords. These three types interact: regional agreements create derogations within the GATT rules; eg: the Czech Republic will have to end its customs union with Slovakia to enter into the EU.

■ The WTO henceforth covers almost all countries. Leaving aside the special situation of Taiwan, the main countries which are not yet members, though they are observers include China, Vietnam, the Baltic states (save Estonia which joined in May 1999), the republics of the former USSR, the Balkan states, Algeria, Sudan and Saudi Arabia. All these countries have asked to join the WTO.

■ Regional accords exist in several forms, running from simple discussion fora to customs unions and lastly to common markets. All the developing countries that were founder members of the WTO in 1995 are also involved in regional accords. Between 1947 to 1999, 194 regional accords were declared to the GATT; 107 are still in place. More than half of all trade today may be qualified as preferential, in other words as managed by an agreement which is not multilateral. The main agreements covering the countries of the South include: i) in the Americas, NAFTA, Mercosur (between Brazil, Argentina, Uruguay and Paraguay) the Andean Pact and the project for creating a pan-American free-trade zone by 2005; ii) in Asia, ASEAN; iii) in Europe, the eastward enlargement of the EU; iv) the South African Development Community (SADC). The term "regional accords" also covers certain intercontinental agreements, such as APEC, the EU-ACP conventions which are currently being re-negotiated, and the Euro-Mediterranean accords.

■ The number of bilateral investment accords increased from 100 in 1980 to 1500 by 1997. The number of agreements on double taxation has also risen substantially. In the wake of such agreements, work on investment is also going on within the regional groups listed above.

appointment of a new Director General. The WTO also includes a mechanism for settling trade disputes, which has real powers to constrain members. Hence, the developing countries can hope to be equally equipped to tackle unilateral sanctions imposed by the rich countries, especially the United States (with its Section 301 of the Trade Act and the Super 301). That the United States was condemned in the dispute over processed petrol (gasoline) with Brazil and Venezuela[7] indicates that developing countries can indeed obtain favourable settlements. From this perspective, membership of an international trade organisation provides benefits not so much in terms of greater openness, but rather as means of managing trade better at an international level.

Table 2 - The Uruguay Round (UR) Negotiations

	Average customs duties pre-UR*	Average customs duties post-UR	% of products subject to consolidated duties before UR	% of products subject to consolidated duties after UR
Argentina	38	31	5	100
Indonesia	20	36	10	93
Malaysia	10	9	0	62
Jamaica	16	50	0	100
Peru	35	30	7	100
Venezuela	50	39	100	100

Source: GATT 1994, brief overview of the results.
*Trade weighted average for consolidated rates and customs rates applied for line items not subject to the consolidated rates. The increase in the indicator for tariffs by some countries is explained by the high level of the consolidated tariff compared to the actual tariff.

The latter argument is especially true for the WTO. Regional agreements between the North and the South (between industrialised and developing countries, such as the NAFTA) do not stem from the same logic. Participation in the latter indicates a far greater and more credible commitment than WTO membership, as their constraints are far stronger. Furthermore, such regional agreements are often seen as an intermediate step to multilateral liberalisation[8]. Lastly, for a developing country, the main advantage of participating in such agreements is that its companies benefit from easier access to the markets of partner countries, which helps attract foreign investment (the phenomenon of tariff jumping)[9]. South-South accords (between developing countries, such as the Mercosur) have more flexible schedules and are grounded in more homogenous circumstances. Liberalisation at the regional level should allow regional "champions" to develop, which will be in a better position to face global competition in a second stage. In addition, such accords make it easier for participating countries to make their voices heard in multilateral negotiations and makes them more visible to outside investors.

A Risky Strategy?

In spite of expected advantages of participating in such international organisations, the actual gains in terms of growth in developing countries appear to be limited. To date, no empirical study has demonstrated that countries taking part in regional or multilateral agreements will systematically experience higher growth[10].

In a world of imperfect information, the signalling strategy appears to be one of the major reasons for making openness official, but it does not rule out risks. To begin with, as soon as most countries adopt such a strategy, then

7. In the name of its Clean Air Act, the United States had set up technical standards concerning the composition of petrol (gasoline). According to Brazil and Venezuela, these standards on their petrol exports to the United States were more restrictive than standards applying to domestic American petrol.
8. That said, the discussion on the relationship between regionalisation and global liberalisation is far from over. One opinion, which is held by the author, maintains that regional accords are a first step on the way to global free-trade. Other commentators argue that such agreements run the risk, in the long term, of creating rival trade blocs which will not be very open.
9. The countries of South-East Asia thus saw competition from Mexico rise after the signing of NAFTA: investments in Mexico have also risen, in order to benefit from the free-trade zone.
10. For example, for the years 1980-1985, the average annual growth rate of developing countries which were members of the GATT in 1986 was hardly greater than the rate for non-members (2.2% versus 2.1% growth). This is a weighted average, in which developing countries are defined as having a per capita income which was less than half the per capita income of the United States, at the start of the period, as was the case for 117 countries.

the signalling impact falls and may lead to developing countries to seek to out-do each other. Whereas such countries benefited from the case-by-case procedure under the GATT, they are now constrained in accepting all the terms of the WTO. But, not all countries actually have the means for applying these clauses: some countries commit themselves to respecting standards which require legal systems they do not have[11]. There is thus a risk, especially during the present period of simultaneous liberalisation by many competing countries and of capital volatility, that false or inappropriate signals may be given out. This could eventually prove deleterious for a country, which may be qualified as a free-rider and hence risk sanctions.

Secondly, joining a constraining organisation may be risky for poorest, small countries because they lack the human resources and state structures which allow them to put forward their interests and defend themselves *vis-à-vis* the rich countries[12]. Similarly, the inability of such countries to carry out studies into the impact of trade policies prevents them from identifying issues they should raise in multilateral negotiations.

Thirdly, it is possible that future negotiations will touch on questions that are especially risky for developing countries: the discussions on the environment and a possible social clause are two representative pitfalls they face. Developing countries, which refuse to apply the new agreements, will then pay the price which will be all the higher given their integration into the world economy.

Lastly, the risks linked to institutionalising openness stem largely from the fact that several organisations seek more to open up member countries' trade rather than help such countries manage liberalisation. Yet greater openness has the potential to generate numerous problems, especially if it is considered as a goal and not as a means, and does not take into account the economic progress of countries or their ability to manage such progress. Thus, the negotiations on agriculture may lead to (excessively) strong disruptions in the social structures of many countries experiencing economic dualism. Similarly, the agreement on intellectual property rights (TRIPs - Trade Related aspects of Intellectual Property Rights), which was signed in Marrakech in 1994 within the GATT framework, and which is therefore compulsory for WTO members, does not recognise the necessity for policies to be appropriate to developing countries. The minimum time-span for patents was thus fixed at 20 years for all countries. A certain number of developing countries thus run the risk of no longer having access to the technology of the industrialised nations which they have imitated up to now, and this could further widen the divergence between economies[13].

Economic practice and theory are susceptible to fashions, and the latter are changing. The Asian crisis appears to have highlighted the necessity of re-examining financial liberalisation. The discussions on the Millennium Round (the trade round to be launched at the end of the year) will provide a good opportunity for going over the ways in which greater economic openness could be a success for the poorest countries. In particular, the WTO should pay more attention to helping such countries overcome the obstacles of greater openness.

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11. The United Nations report on trade and development in 1994 provides a clear presentation of the Uruguay Round: the costs of implementing the TRIPs accord in Bangladesh necessitated outside financing (UNCTAD, ***Trade and Development Report Supporting Papers***, 1994, p 202).
12. Some organisations, such as the WTO, are aware of this problem and help developing countries train their personnel, assess their policies etc.
13. See L. Fontagné and J.L. Guérin, "Innovation, imitation et rattrapage en présence de rigidités sur le marché du travail", ***Revue Economique*** n°48 (5), 1997.

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