Developing Countries Need to Open Markets to Each Other

David Dollar

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Auto shoppers in Malaysia have more choices since the country opened its markets to imports from neighboring Southeast Asian countries.

Fully half of the benefits to developing countries from stalled multilateral trade negotiations would come from getting better access to each other's markets. They would gain more by lowering their own barriers to agricultural trade than they would by wealthy countries lowering their barriers, although the latter also must happen.

With two-thirds of the industrial goods tariffs paid by developing countries going to other developing countries, further trade liberalization could attract foreign investment and advance developing country growth. Completing the Doha Round trade negotiations will require real leadership on the part of the developing world, especially the big developing countries that have benefited so much from globalization.

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The Doha Round of multilateral trade negotiations is stalled and may very well fall apart. This round of trade liberalization was supposed to be the World Trade Organization's "development round" that would provide benefits in particular to developing countries, which are home to 1 billion people living on less than $1 per day and 2.6 billion living on less than $2. How would a new round of trade liberalization help poor countries?

Opening Agricultural Markets

The most obvious issue—and the one that has received the most attention—is the ongoing agricultural protection of rich countries. Japan protects rice and other markets. The United States and Europe subsidize and protect farmers. Completely liberalizing agricultural markets in rich countries would provide an immediate annual benefit to developing countries of $26 billion, according to a recent World Bank estimate. To put this number in context, it is about one-half of the annual flow of foreign aid from rich countries to poor ones. Thus, opening agricultural markets in rich countries is one important issue.

Less well publicized is the fact that opening the agricultural markets of developing countries would provide to these countries a similar—even slightly larger—gain of $28 billion per year. This gain comes partly from the fact that trade liberalization will enable each country to expand production of goods and services that the country makes efficiently and sell them at better prices. Another benefit from trade is that consumers will buy at lower prices goods and services that their country does not produce so well.

In addition, developing country liberalization would stimulate South-South trade—trade among developing countries—providing benefits to other poor countries. Where it can be achieved, liberalization of markets for staple foods can particularly help reduce poverty, since these goods account for a large share of expenditure of poor households in developing countries.

Cutting Industrial Tariffs

While a lot of attention in trade discussions focuses on the agriculture issue, there is an equally strong case for further liberalizing markets for industrial products. Many developing countries are now efficient producers of manufactured products, especially labor-intensive ones such as textiles and electronics. In fact, 80 percent of the exports of developing countries are manufactured products.

The largest markets for industrial goods are in the rich countries, but their import tariffs are already relatively low. Right now, about two-thirds of all industrial tariffs paid by developing-country producers are paid to other developing countries because import tariff rates for industrial products tend to be higher in developing countries.

Developing countries thus have a lot to gain from better access to each other's markets. This will enable more efficient firms to expand production and achieve scale economies and will encourage more specialization, as has been seen during European integration over recent decades.

The phrase "development round" may suggest to some that the key objective of the current round is to get rich countries to drop their barriers against goods from poor countries. But that move alone would provide only half of the potential benefit that developing countries could gain from a more open trading system. Fully half of the potential benefit to developing countries of trade liberalization comes from better access to each other's markets.

Dynamic Benefits

The benefits that I have discussed so far are what economists call "static benefits"—gains that could come quickly based on current production capabilities. Full trade liberalization would lead to the developed countries reducing production of certain agricultural products, while such production expanded in developing countries having adequate land and water. Developing countries would also expand production and export of labor-intensive manufactures, whereas developed country production would tend to shift into heavy machinery, technology-intensive products, and services. But beyond these static gains, there are also important dynamic benefits. The dynamic effects are hard to quantify, but they are arguably more important than the static gains.

What we mean by dynamic benefits is that connecting to a large, global market tends to stimulate innovation and productivity growth at the firm level. Innovation is not just major technological breakthroughs; it is most commonly small changes in the process or products of a firm. Firms in protected markets tend to become complacent, whereas a large competitive market provides a significant outlet for good ideas and high-quality production.

The large market also provides for a finer division of labor. A developing country that lowers its own import barriers against manufactured products will typically find that its firms become part of global production networks in which different components and activities that feed into one final product originate in different countries.

For developing countries to take part in sophisticated global production networks, they need to have investment climates in which it is relatively easy for firms to start up and expand. They need good transport links to the wider world and efficient customs administration.

A final point about the Doha Round is that it is also trying to take up issues of liberalizing trade in services. Many modern services contribute to a good investment climate: finance, insurance, logistics, port management, and transport services, to name a few. Liberalizing imports of these modern services can help developing countries build a stronger investment climate so that their firms can more easily take advantage of global market opportunities.

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This apparel factory in Lesotho stands to gain from the elimination of tariffs on trade with its neighbors in the Southern African Customs Union.

Political Leadership Needed

A comprehensive round of trade liberalization will provide benefits to all the countries that are members of the World Trade Organization. If that is true, then why is it so difficult to strike a deal?

The well-known political problem with trade liberalization is that a more open market provides diffuse benefits to the whole population, but also imposes large adjustment costs on some specific industries. Of course, the protected farmers in the rich countries lobby against trade liberalization in their sectors. The protected industrial firms and service industries in developing countries likewise lobby. So it takes real political leadership from each country to bring about a deal.

It is also both smart and humane to be aware of the losers and to design as much as possible compensation schemes to ease the adjustment. Many countries have adjustment assistance programs to help workers retrain or relocate so that they can take advantage of the opportunities opened up by expanded trade.

Previous trade liberalization rounds have appeared close to collapse before an eleventh-hour deal emerged. So for the sake of poor countries, let's hope that political leadership is found all around. A Doha deal will require significant movement on the agricultural protection issue from the United States, Europe, and Japan. But it will also require real leadership on the part of the developing world, especially the big developing countries that have benefited so much from globalization. Further trade liberalization for industrial products and services is very much in the interest of the developing world, but developing country leaders will have to convince their populations of this and find smart ways to help the people who are temporarily hurt during the adjustment. ■

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