You are conducting a literature review on the impact of trade liberalization on imports, exports, and the overall balance of trade. You are particularly interested in cross-country studies.

Your research question is, *What is the impact of trade liberalization on imports, exports, and the overall balance of trade?*

Below are three extracts from articles that are relevant to your research question. Read them and extract information you will need to answer your research question. Then write an argument summarizing the literature you have found.

Extract 1. This extract has been adapted from the *United Nations Conference on Trade and Development, Trade and Development Report 1999.*

In many countries, the combination of rapid trade liberalization, opening up of the capital account, and mismanagement of the exchange rate has produced large trade imbalances without generating rapid and sustainable growth.

The evidence presented in table 4 strongly supports these considerations, and it is consistent with the evidence on the overall behavior of exports, imports, and trade deficits of developing countries. The table provides information on the behavior of exports, imports, and real exchange rates in 15 developing countries, five each from Latin America, Asia, and Africa, during the period following trade liberalization in these countries. In most of these countries, trade liberalization was implemented after the mid-1980s. Many also opened their capital accounts soon thereafter. In the table, a distinction is made between the behavior of exports and imports in the immediate aftermath of trade liberalization (that is, within the first two years—period I) and during subsequent years (period II).

In the first two years of trade liberalization, imports grew faster than exports in all countries except three of the African ones (Ghana, Morocco, and Tunisia), where it should be noted that the real exchange rate depreciated during the same period. However, for Brazil, Malaysia, and the Philippines, depreciation did not always succeed in pushing exports ahead of imports, confirming that it cannot always offset the adverse impact of trade liberalization on the trade balance. In all other cases, trade liberalization was associated with real appreciation, thereby adding to import surges generated by tariff cuts, especially in Argentina, Kenya, Mexico, and Turkey. Thus, in most cases, rapid liberalization was followed by a combination of large inflows of capital, currency appreciation, and mounting trade deficit, but often ended with a crisis involving a reversal of capital inflows, collapse and overshooting of exchange rates, sharp cuts in imports, and a strong economic contraction.

See table on next page

Table 4

GROWTH OF IMPORTS AND EXPORTS AND MOVEMENTS OF THE REAL EXCHANGE RATE AFTER TRADE LIBERALIZATION IN SELECTED DEVELOPING COUNTRIES

		First two years after trade liberalization (Period I)			*Subsequent 10 years[a] (Period II)*		
		Growth[b] of		*Real exchange rate[c]*	*Growth[b] of*		*Real exchange rate[c]*
Country	*Year of trade liberalization*	*exports*	*imports*		*exports*	*imports*	
Latin America							
Argentina	1991	2	65	87	22	13	76
Brazil	1990	2	5	110	8	33	104
Chile	1976	17	31	98	9	4	119
Colombia	1991	2	24	93 [d]	14	12	75 [d]
Mexico	1986	6	18	93	15	16	64
Asia							
Indonesia	1986	2	9	..	13	16	..
Malaysia	1988	18	32	103 [d]	18	18	104 [d]
Philippines	1986	15	18	107 [d]	15	19	98 [d]
Thailand	1986	31	32	98	17	19	86
Turkey	1989	5	15	85	11	18	82
Africa							
Ghana	1985	22	18	141 [d]	12	21	247 [d]
Kenya	1993	12	21	82	..	..	72
Morocco	1984	7	2	157 [d]	7	9	119 [d]
Tunisia	1989	16	13	103 [d]	9	9	100 [d]
Uganda	1988	-21	-25	136 [d]	35	39	242 [d]

Source: UNCTAD database; IMF, *International Financial Statistics*, CD-Rom.
a Subsequent (under 10) years until 1996, where liberalization was after 1986.
b Annual average growth of value in per cent.
c Index of average real exchange rate with the dollar, unless otherwise indicated (year of trade liberalization = 100); an increase in the index indicates a depreciation of the currency.
d Real effective exchange rate.

Extract 2. This extract has been adapted from *An Empirical Evaluation of the Macroeconomic Effects of Tariffs* (Journal of International Money and Finance (1992), 11, 63-79) by Jonathan D. Ostry and Andrew K. Rose.

In this paper, we analyze the macroeconomic impact of tariffs. Two points are emphasized. From a theoretical perspective, increases in tariff rates cannot be unambiguously associated with movements in output and the trade balance; the latter may rise, fall, or remain unchanged after exogenous tariff changes. Empirically, we cannot reject the hypothesis that tariffs are statistically insignificant determinants of output, the trade balance, and the real exchange rate. Five separate databases and a variety of statistical techniques are used to examine the robustness of our conclusions.

Our paper is motivated in part by the absence of clear-cut theoretical predictions about the macroeconomic impact of tariffs. More important, we provide the first econometric attempt to assess the macroeconomic effects of tariffs. Further, we address an issue of current policy concern. Branson (1987) suggests an across-the-board tariff increase to reduce the size of current American trade deficits; proposals of trade restrictions against countries whose bilateral trade deficits with the USA exceed some critical value have also been widely discussed (e.g., in the 1988 Gephardt Amendment). The macroeconomic impact of protectionist policies has also been of historical concern. For instance, the infamous Smoot-Hawley Tariff Act was passed in part because of congressional beliefs that tariffs would be expansionary; Kindleberger (1986) argues that the macroeconomic effects of Smoot-Hawley were contractionary and exacerbated the Great Depression.

In the following section, a variety of existing theoretical models are briefly surveyed in order to show theoretically that tariffs may have a wide variety of effects on the macroeconomy, including no effect at all. The main conclusion which emerges from the empirical analysis is that there is little evidence that fluctuations in tariff rates have actually had statistically significant effects on such important macroeconomic variables as the trade balance, the exchange rate, and the level of economic activity. We demonstrate the robustness of this conclusion by perturbing our methodology in a number of different ways, and by using five different sets of data. The data bases consist of:

1. Short-run bilateral data between the USA and six major trading partners [six other countries in the Group of Seven (G7): UK, Canada, France, Germany, Italy, and Japan].
2. Short-run aggregate data between the USA and all of its trading partners.
3. Long-run US-UK bilateral data.
4. A short aggregate panel for 38 countries.
5. Long-run aggregate data for 14 OECD countries.

<u>Extract 3</u>. This extract has been adapted from *The Impact of Trade Liberalisation on Exports, Imports and the Balance of Payments of Developing Countries* (The Economic Journal, 114 (2004), 50–72) by Amelia Santos-Paulino and A. P. Thirlwall.

Trade liberalisation may promote growth from the supply side but, if the balance of payments worsens, growth may be adversely affected from the demand side because the payments deficits resulting from liberalisation are unsustainable and not easily rectified by relative price (real exchange rate) changes (Khan & Zahler, 1985).The purpose of this paper is to examine this issue in a systematic way taking 22 developing countries from different continents that have undergone extensive trade liberalization since the mid-1970s. We are interested in answering four major questions. First, what has been the effect of trade liberalization on export and import growth in the aggregate for all countries in the sample and, are there differences between the major regions of Africa, Latin America, East Asia, and South Asia? Second, has the impact of liberalization been greater on export growth or import growth? Third, how has liberalization affected the price and income elasticities of demand for exports and imports? Last, what has been the effect of liberalization on the trade balance and the current account of the balance of payments of countries: Has there been improvement or deterioration? Theoretically, the effect of liberalization on the trade balance or balance of payments is ambiguous whatever framework of balance of payments adjustment theory is used, so the issue becomes an empirical one. The results have policy implications relating to the sequencing of export and import liberalization. If foreign exchange shortages are to be avoided, the goal must be to liberalize in such a way as to keep the current account of the balance of payments in equilibrium, or at least at a level sustainable through long-term capital inflows without the need for deflation. Achieving the right balance between import and export growth in the trade liberalization process can be as important as getting the sequencing right between internal and external financial liberalization. To our knowledge, this is the first study to look at this topic in a systematic way, using different estimation procedures, and different measures of liberalization.

The results of the analysis undertaken are strong and robust to the different estimations techniques used, which means that the conclusions can be presented with some confidence. First, reductions in export and import duties have significantly affected the growth of exports and imports, with the impact on import growth being greater. For a one percentage point reduction in duties, exports have grown by just under 0.2%, while imports have grown by between 0.2 and 0.4%.

Second, the impact of a more liberalized trade regime, in all its manifestations, independently of duty reductions, has raised import growth by more than exports. Evidently, it has been easier for importers to import than for producers to reallocate resources to the traded-goods sector and to capture export markets. Compared to the pre-liberalization regime, the process of liberalization has raised export growth by approximately just under 2%, while import growth has increased by about 6%.

Third, liberalization has increased the income elasticities of demand for imports and exports by roughly equal amounts but has increased the price elasticity of demand for imports by more than for exports. Fourth, the pure effect of trade liberalization, independent of duty changes, has been to worsen the trade balance by over 2% of GDP but the impact on the current account of the balance of payments has been less, worsening it by approximately 0.8% of GDP on average. The effects of liberalization on the trade balance and balance of payments have been similar across the regions of Africa, Latin America, East and South Asia, in the sense that all the regions have suffered deterioration.

Fifth, the impact of liberalization differs according to whether countries start highly protected or whether they already have relatively low levels of protection. The positive effect of liberalization on import growth and the negative effect on the trade balance and balance of payments are all greater in the more highly protected countries.

Sixth, it appears that liberalization has had a net positive effect on income growth but the balance of trade consequences may have reduced growth below what might otherwise have been had a balance between exports and imports been maintained.

One policy conclusion from our results would be, therefore, that countries (and international organizations that promote trade liberalization in developing countries) need to take great care in the sequencing of the liberalization of exports and imports to achieve a better balance between export and import performance if countries are to realize their potential growth performance. Free trade and flexible exchange rates are no guarantee that unemployed domestic resources are easily converted into scarce foreign exchange.

APA Reference:	
Findings:	Evidence/Support:
APA Reference:	
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Findings:	Evidence/Support:

Homework

Write an argument summarizing the results of cross-country studies on the impact of trade liberalization on imports, exports, and the balance of trade.

Model paragraph from Ju, J., Wu, Y., & Zeng, L. (2005). *The impact of trade liberalization on the trade balance in developing countries* (IMF Staff Papers, 57[2]).

> For policymakers, the impact of trade liberalization on the overall balance would be [an] important question. There have been, however, surprisingly few cross-country empirical studies on the subject. Ostry and Rose (1992) studied the impact of tariff changes on the trade balance using five different data sets, mostly data from the Organization for Economic Cooperation and Development countries, and found no statistically significant effect. UNCTAD (1999) studied the effect of trade liberalization on the trade balance for 15 developing countries over the period of 1970–1995, and found a significant negative relationship. In a more recent paper, Santos-Paulino and Thirlwall (2004) studied the effect of trade liberalization on imports, exports, and on the overall trade balance using a sample of 22 developing countries for the period of 1972–1997. They found that liberalization stimulated export growth but raised import growth by more, leading to a worsening of the overall trade balance. (p. 429)