Opening up the economy

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IN my article published in this space on October 26, I went over some arguments presented by economists of different persuasions about the importance of economic openness and expanding international trade for accelerating growth and reducing poverty.

Although there are serious differences among economists as to the amount of importance that should be given to international commerce for promoting growth, I came down on the side of those who argue that an export promotion strategy has a better chance of succeeding than the one that puts emphasis on import substitution.

This is particularly the case for a country such as Pakistan that has developed a reasonable industrial base behind a high wall of tariff and non-tariff barriers. Pakistan's industry and other modern sectors of the economy are today more protected against foreign competition than is the case with other countries of its size and at its stage of development.

Continuing with this approach would prove to be costly since industries in the country will not be able to compete with those in other parts of the world. This would be unfortunate since international commerce has become the driving force behind global development and prosperity. Pakistan cannot afford to be left out of this game. It should now make a serious effort to bring efficiency to the hitherto protected industrial base. This it should do by allowing much greater international competition.

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than that adopted by Poland. The country's economy grew at an unprecedented rate, which was maintained over a long period of time. The debate would have been hard to settle with two successful outcomes from two very different approaches to opening to the world outside had a setback not occurred in the reforming world.

The turbulence caused by the pursuit of the Washington Consensus policies in both East Asia and Latin America gave pause to those who had favoured speed over caution. Even the International Monetary Fund, the most ardent advocate of fast opening, began to advise caution after the heavy damage done by the Asian Financial crisis in 1997-99. But the Fund's change of heart applied to financial opening, not to trade openness. In trade, it continued to argue for rapid removal of constraints — of high walls of tariff and non-tariff barriers.

How open a trading system should be is a question that leads to another debate and different set of recommendations. Economists such as Joseph Stiglitz, the Nobel Laureate, have argued that it is not prudent to push the developing world

because of their unwillingness to agree to the trifling concessions offered by the European Union, Japan and the United States on trade in agricultural products that the developing countries pushed the ministerial talks at Cancun, Mexico, in 2003 to fail. A group of poor countries in West Africa was the most disturbed by what was on offer at Cancun, particularly in cotton trade, a vital crop for them but which was heavily subsidized by the United States.

International trading arrangements that result from long drawn-out negotiations are not the only way for the developing world to move towards openness. This can be done in several other ways, particularly in the context of regional trading arrangements, or RTAs. While the European Union is by far the most successful RTA, regional arrangements have also become popular in many parts of the developing world, particularly in Latin America and East Asia. Most successful RTAs are among countries at about the same stage of development. That is certainly the case for the European Union.

The North America Free Trade Area is the only example of a successful regional arrangement involving developed and developing countries. The Nafta has brought together Canada, Mexico and the United States. In spite of the serious misgivings in the United States about the wisdom of a trading arrangement with a populous developing country, there is a broad consensus among experts that the NAFTA has benefited all partners involved in it.

Are there lessons for South Asia from the experiences of regionalism in other parts of the world? Broadly speaking, Europe, East Asia and Latin America followed a different approach in moving towards regional integration. The European drive was motivated in part by a political judgment: that by gradthe hitherto protected industrial base. This it should do by allowing much greater international competition.

behind global development and prosperity.

How should a relatively closed economy move towards openness, how open should it become and over what period of time should this openness be achieved? Once again, in finding answers to these three questions, we run into good deal of debate among serious economists. In the 1990s, Washington based economists operating out of the multilateral development institutions and development think tanks developed a strategy for the developing world that came to be known as 'The Washington Consensus'. This strategy put a great deal of emphasis on openness to the world outside. Developing countries were advised to open their economies in three different ways.

They were advised to remove capital controls and allow foreign capital to flow in and out without too many constraints. They were told to permit trade to be unencumbered as much as possible. Some advisers went as far as to suggest that the developing world should not look for reciprocity. A "tit for tat" approach in trade did not make good policy. And they were counselled to allow foreign companies to compete in the programmes of privatization of the assets held by the government.

It did not matter whether the entities being privatized were industries, commercial banks, airlines, power plants or public utilities. Inviting foreigners to come into these sectors would be enormously beneficial as they were likely to bring in not only new technology and management practices. They were also likely to make additional investments. But how quickly should this drive towards openness be undertaken?

There were two answers to this question. There were those who believed in the "big bang" theory of economic reform. It was argued that closed economies should be opened quickly; doing so slowly would create a number of additional distortions. Gradual opening also developed vested interests that, over time, were likely to become serious opponents of further opening. The big bang approach was tested in a number of East European countries that were in the process of shedding Soviet-style economic systems in favour of market capitalism. Poland was the most important testing ground for this approach and its relatively better economic performance gave heart to the exponents of this radical strategy aimed at economic reform and transition.

Among the socialist countries, China took an entirely different approach. It was extremely deliberate in deciding on the process of reform — how it should be introduced, to which sectors it should be applied, how fast should the changes be made? China's approach was even more successful different set of recommendations. Economists such as Joseph Stiglitz, the Nobel Laureate, have argued that it is not prudent to push the developing world towards openness while the parts of the economies of rich countries that are of interest to the poor countries remain relatively closed. These economists don't buy the approach that tit-for-tat approach in international trade is counterproductive. According to Stiglitz, writing in his best-selling book, *Globalization and its Discontents*, while rich countries "had preached — and forced — the opening of the markets in the developing countries to their industrial products, they had continued to keep their markets closed to the products of the developing countries, such as textiles and agriculture. While they preached that the developing countries should not subsidize their industries, they continued to provide billions in subsidies to their own farmers, making it impossible for the developing countries to compete. While they preached the virtues of competitive markets, the United States was quick to push for global cartels in steel and aluminium when its domestic industries seemed threatened by imports." Trading systems in the developing countries should certainly not be more open than those in rich countries. In fact, there are good reasons why they should be less open.

The Washington Consensus advocates advised the developing world to be unilateralists in their approach to openness. They did not have to wait for other countries to be equally accommodating. Such a purist approach may be justified by theory but the world is seldom ordered to conform to the basic principles of economics. Because of the distortions that exist in the international trading system, it makes a great deal of sense for the developing countries to reform their systems within the context of international negotiations such as those currently under way in the context of the Doha round.

The last time such a round was conducted — the Uruguay Round — the developing world stayed on the sidelines. The Uruguay discussions centred mostly on the interests of the developed world. It was only in the latter part of the discussions that poor countries were able to exert some pressure, which resulted in the agreement to do away with the Multi-fibre Agreement (the MFA) and to the promise by the developed world that the liberalization of trade in agriculture will be the main subject for any further negotiations.

The developing countries, having learnt a lesson from their experience in the Uruguay round, have played a much more important role in the Doha negotiations. In fact, it was involved in it.

Are there lessons for South Asia from the experiences of regionalism in other parts of the world? Broadly speaking, Europe, East Asia and Latin America followed a different approach in moving towards regional integration. The European drive was motivated in part by a political judgment: that by gradually integrating the continent's economies it should be possible to resolve the political and territorial differences that had resulted in two highly destructive wars. In finding a common economic ground among the nations of Europe, the founding fathers started modestly.

They began with the integration of steel and coal industries and markets. Since the ownership of these industries was in mostly private hands, integration meant drawing up of common regulatory frameworks for trade in these commodities as well the prices that could be charged. From that modest start, and after some serious obstacles were overcome, the European free trade area evolved into a modern 25-nation trading and economic union that is today the world's largest economy. That is if the EU can be treated as economy rather than a composite of 25 individual economies that work together on some issues.

The East Asian motives for moving towards integration were both political and economic. Several decades ago, the smaller countries of this region realized that they needed to aggregate their interests in order to counter the influence of mega powers in the area — China, Japan and the United States. Again, as was the case with the European Union, the Association of South East Nations began modestly. It has gained in stature as the economies of the region developed and some of them became major trading nations, particularly in products with high technological content. That notwithstanding, the ASEAN will take time before it moves towards an EU type of economic and trade integration.

Finally, Mercosur, the trading bloc involving four countries of the southern part of Latin America — Argentina, Brazil, Paraguay, and Uruguay with an associated status for two more countries, Chile and Bolivia — was formed mostly for economic reasons. The idea was to create a large Latin American market for the countries of the area.

At best, Mercosur's record is mixed. During periods of extreme economic distress — and Latin America has seen several of these — the member countries have been inclined to go on their own rather than be mindful of the impact such actions will have on their collective enterprise. What are the lessons of all these experiments for the countries of South Asia? We will come back to this question next week.