वाणिज्य एवं उद्योग मंत्रालय
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Azadi Ka Amrit Mahotsav

Openness to Trade: Economic and Policy Considerations

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Importance of Trade Liberalisation

- Trade liberalization is an agent of economic change, but evidence shows that it does not lead to drastic changes in a country's overall production structure. Policies that make an economy open to trade and investment with the rest of the world are needed for sustained economic growth. The evidence on this is clear. No country in recent decades has achieved economic success, in terms of substantial increases in living standards for its people, without being open to the rest of the world.
- Opening up their economies to the global economy has been essential in enabling many developing countries to develop competitive advantages in the manufacture of certain products. There is considerable evidence that more outward-oriented countries tend consistently to grow faster than ones that are inward-looking.
- A strategic approach identifies key objectives, policy measures to achieve them effectively, prioritization amongst objectives and sectoral initiatives, monitoring and improvement of policy initiatives to enhance effectiveness, close consultation with domestic producers (including FDI), reducing obstacles to operational difficulties, and an approach to augment access to global markets.
- An understanding of the impact of policies on key objectives helps prepare the relevant approach to trade policy, based on policies and experience of countries which have successfully emerged as major exporters in several sectors.

Role of Exports in Growth

- Exports effectively allow the country to exploit its cost advantage. Symmetrically, the country's own production costs in products it imports are higher than those of its foreign counterparts. In effect, the reliance on exports as the engine of growth allows the country to exploit its comparative advantage.
- When economies of scale are present, domestic market of a developing country often proves too small to allow their full exploitation. This is especially the case at the early stages of development when even countries with large population such as India and China can end up with relatively small domestic market due to a low per-capita income.
- The experience of China during the past two decades shows that in many industries it takes a very large scale before scale economies are fully exploited. When countries try to promote industries subject to scale economies through import substitution using protective custom duties and production subsidies as policy instruments, the outcome is often an unhappy one.

- Attracted by the subsidies and high prices resulting from the custom duties, too many small producers enter the market with none large enough to successfully compete against large-scale, globally competitive manufacturers. And once these inefficient producers become entrenched, removal of custom duties becomes politically challenging since it inevitably carries the threat of job losses.
- Near-free-trade regime required to implement an export-led-growth strategy demands that producers of exportable as well as import-competing products compete against the best of in the world in their respective industries. Such competition keeps entrepreneurs continuously on toes and forces high levels of discipline, hard work and efficiency for survival. Finally, free flow of exports and imports diffuses product innovation and production technology.

Protectionism (Import substitution) Vs Openness

- It is not uncommon for policy makers in developing countries to think that they can pursue a successful export-led growth strategy simultaneously with import-substitution industrialization. Indeed, some think of import substitution as a means to export-led growth. While import substitution in one or two sectors may do only a small damage when the country is otherwise open to imports, its wholesale pursuit is incompatible with an export-led-growth strategy.
- Restrictions on imports necessarily serve as restrictions on exports. At a technical level, this point goes back to the famous Lerner Symmetry theorem of international trade theory which says that a 10% tariff on all imports is identical in all respects to a 10% tax on all exports.
- Intuitively, discrimination in favour of one set of industries amounts to discrimination against the remaining set of industries. By raising the prices of importable products, tariffs encourage consumers to shift expenditure towards exportable products and producers to shift resources away from those products. Both changes contribute to less of these products being left for exports.
- Trade openness in the sense of neutrality or neutral trade orientation of an economy may have a positive impact on economic growth in the short run by an enlarged trade sector for example trade related investments in the economy boosted imports via increases in income and aggregate demand. However, at the same time the relationship between trade openness and economic growth in the long run is determined by a host of factors but predominantly by the abilities of local firms and industries to adjust and cope with the international productivity levels and their ability to develop imitative and absorptive capabilities necessary to internalise economies of scale and knowledge externalities – related trade.

Factors affecting Exports competitiveness

- Sometimes, exports never lie in its volume, but in its structure. The structure should be in place to be able to absorb and adapt to the shifting factors affecting the country's balance of trade (defined by its net exports or exports minus imports). These factors include everything from political circumstances, currency exchange rates, social/consumer behaviour, factor endowments (labour, capital and land), productivity, to trade policies, inflation and demand.
- Inflation increases the cost of production and a real appreciation of the currency, which reduces domestic firms' international competitiveness and discourages firms from

engaging in the manufacturing sector. So, the government has to control the general inflation level. 4

- A higher GDP means a higher production capacity, which translates into the economy's ability to export more (supply-side). So, the policy implication is that the government has to promote the competitiveness of the manufacturing exports where the government has to use effective and efficient government expenditure to increase the manufacturing sectors value-added.

Role of FTAs in Trade Liberalisation

- In principle, Free trade Agreements on the international level is no different from trade between neighbours, towns, or states. However, it allows businesses in each country to focus on producing and selling the goods that best use their resources while other businesses import goods that are scarce or unavailable domestically. That mix of local production and foreign trade allows economies to experience faster growth while better meeting the needs of its consumers.
- Free trade Agreements is an opportunity to open another part of the world to domestic producers. Moreover, free trade is now an integral part of the financial system and the investing world. American investors now have access to most foreign financial markets and to a wider range of securities, currencies, and other financial products.

Role of WTO in Trade Liberalisation

- Trade liberalization is a cardinal principle of the World Trade Organisation (WTO), through its origin could be traced to the structural adjustment programmes of the international financial institutions (The World Bank and the IMF) in their attempts to incorporate developing countries into the capitalist development paradigm.
- In order to hasten this process of incorporation, countries especially from the developing world were mandated to liberalise their economies, including their trade relations with the rest of the world. Thus, every member country of the world trade body while acceding to the document that embodies the WTO agreement undertakes to liberalise its trade.