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RESEARCH NOTES

TRADE INTEGRATION BENEFICIAL OR BURDEN FOR DEVELOPING COUNTRIES!

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I. Introduction

The international trade enhances the economic growth through efficient allocation of resources, spurs competition, increase flow of knowledge and investment, and enhances the rate of capital accumulation in an economy; while empirical evidences suggest that barriers to trade restrain export potential are below optimal level [Santos-Paulino and Thirwall (2004)]. The trade liberalization reduce barriers to the movement of goods and services among the nations and appears to be a powerful system for promotion of economic growth and development. Over the last few decades the world trade has grown on an average of over 6 per cent per year, which is twice the world output. According to Bhagwati [(1978), (1988)] and Krueger (1997), "any policy which reduces the anti-export bias will move towards liberalization of trade" and reduction the import license premium is necessary step towards trade liberalization regime [Edwards (1993)]. He also demonstrated that trade liberalization eliminates trade distortions, such as import tariffs and export subsidies.

The new growth theory propagates that trade liberalization expands global market, promote research and development, increase movements of knowledge and skills among nations and reallocate human capital in more innovative manners [Thomas and Nash (1991), Weiss (1992), Arsalan and Wijnbergen (1993)]. However, trade liberalization entails cost; the most significant setback due to reducing tariff which is the loss of government revenue in developing countries. If tariffs are reduced or eliminated, the developing countries impose other taxes to their citizens in order to keep its budget in line, which causes economic imbalances in an economy. To develop more outward-oriented or liberalized trade policy regime, there is a need to control the internal and external factors. The General Agreement on Tariffs and Trade (GATT) and the World Trade Organization (WTO) have been the key forces for free trade which substantially reduced and dismantled barriers to trade, i.e., quotas, licenses and technical specifications, among other restrictions [Santos

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and Amelia (2005)]. Accordingly, trade liberalization is beneficial for all economies regardless of their size and level of growth and the aggregate gains from free trade outweigh possible losses of free trade, irrespective sectors and size of the country. Though, free trade enlarges pie but distributes unequally among various countries in accordance with their size [Shafaeddin (1994), Jenkins (1996), Krueger (1997)]. Consequently the trade liberalization has enhanced the living standards around the world; while in many developing countries' prosperity has raised, few gain considerably.

The share of developing countries in the world trade has significantly increased, during the last four decades and their export of manufactures and services relative to primary commodity exports have substantially increased. The developing countries manufactures export accounted eighty per cent of their total exports. Moreover, international trade between developing economies grew very fast in the recent years - over forty per cent of their export goes to other developing countries. Export growth is very important for achieving economic growth, stability and sustainability [Khan (1998), Greenaway and Sapsford (1994), Weiss (1992)]. The efficacy of any country's trade policy in relation to its export performance is highly dependent on demand of its exports, productive potential of the exportable goods, composition of commodity exports, and diversification of variety of exportable commodities, and on the free preferential trade agreements with regional and non-regional economies.

The rate of economic growth and distribution of income, wealth and resources in a country are closely related to export growth. On one hand, if export increases at a faster rate as compared to its imports, nothing can stop an economy from being a developed nation. On the other hand, the instability in exports growth can adversely affect the process of economic development, because fluctuation in export earnings generate uncertainties in an economy. These uncertainties influence the economic behaviour by adversely affecting the level and competency of investment and in turn have a negative effect on growth. The contrary view of the picture is that immense amount of uncertainty on export proceeds also brings risk aversion. The risk averse investors invest relatively more domestically and this may constrain the economic growth; but however, currently it is not a much observable fact. Trade liberalization could be beneficial when magnitude of international trade of a country grows at a faster rate. Exports of a country are vital for its economic performance relatively due to the high profitability and foreign exchange earning potential.

II. Trade liberalization Experience of Developing Countries

Immense literature on relevant issue is present for both the developed and developing countries, indicating a profound impact on economic growth through liberalization of international trade. [e.g., Alexander and Warwick (2007), Hassler (2004), Marhubi (2000), Sarkar (2005) and Tanaka (2007), Authukorala (1991),

Edwards and Alves (2006), Mouna and Reza (2001) and Mwaba (2000)]. Similarly, trade liberalization appeared to be a significant catalyst for the enhancement of export promotion across the globe [Michealy, et al. (1991), Thomas, et al. (1991), Joshi and Little (1996), Bleaney (1999), Ahmed (2000), and Santos-Paulino (2002), (2007)]. However, few recent studies on the issue negate such positive relationship though the results remain inconclusive [Clarke and Kirkpatrick (1991), Greenaway and Sapsford (1994), Jenkins (1996), Agosin (1991) and Shafaeddin (1994)].

Weiss (1992) finds that trade liberalization policies and the reduction in domestic demand is the major source of export growth in Mexico. Roy (1991) analyzes the relationship between export performance, exchange rate devaluation and effective rate of assistance in Bangladesh between 1976-77 and 1986-87, and concludes a significant positive association among them. Trade liberalization has fastened the pace of growth of exports while specialized industrial policies stabilize the pattern of growth in the countries. However, such relatively strong performance of foreign trade sector in developing counties is being constrained due to their weak institutional and underdeveloped infrastructure. Analysis from Nepal [Sharma, et al. (2001) and Jenkins (1996)] reveals such weak relationship between liberalization of trade and export growth. Similar marginalized impact of liberal trade policies over the export performance of many African countries (export to GDP ratio grew only by 0.9%) duly verified the importance of standard institutional setup, developed infrastructure as the pre-requisite to have noteworthy association between trade liberalization and export performance of developing countries [UNCTAD (2008), Babatunda (2009), and Sharma, et al. (2001)]; whereas, the recent empirical investigation employing more robust estimation techniques and issue concerned, reveals that real income of the importing countries and depreciation of exporting countries foreign exchange value are major factors for relatively higher performance of exports of developing countries, particularly true for African region countries [Olofin and Babatunda (2007)].

Furthermore, export performance of several developing countries has shown a significant rising trend during the post-liberalization period but was unable to convert, relatively better performance towards higher economic development due to presence of the persistent trade deficit because of the comparatively higher growth of their import value than the export value. Even though significant transfer of technology and massive reduction in export duties could not help them to amplify their manufactured exports, except for India [Hoque and Yousuf (2012), Kassim (2012), Herath, et al. (2013), and Paudel (2014)].

Khan (2006) analyzed the level of potential trade flows between Pakistan and ECO member countries and found that Intra-ECO trade had large potential for Pakistan but the actual trade was lower than its potential. Khan (2010) estimated a gravity model employing bilateral trade flows for 137 countries in 2005. The study further established that the then scale of trade was assigned to t;he regional

agreements rather than the unilateral liberalization, and suggested larger scope for regional cooperation among ECO member countries. The study further reveals that the total trade between member countries was also lower than the potential. The advantage of geography and the existence of trade preference between ECO member countries could be extended to cover the potential trade towards neighbouring countries. Rahman, et al. (2006) tries to identify 'trade creation' and 'trade diversion' effects deriving from the SAARC Preferential Trading Arrangement (SAPTA) and the other Regional Trading Agreements (RTAs) by using Panel data approach with country 'pair specific fixed effects' and 'year specific fixed effects'. This note reveals that a significant intra-bloc export creation in 'SAPTA'. It further suggests that P akistan, Bangladesh and India could be expected to achieve benefits from involving with the 'RTA', whereas, Maldives, Sri Lanka, Nepal are expected to be affected negatively. Thailand and European Union APTA are found to be net export diverting and intra-bloc export diverting. BIMSTEC (Bangladesh, India, Myanmar, Sri Lanka and Thailand Economic Cooperation) is found to be intra-bloc export diverting, but however there is no evidence found about net export diversion or creation. Though, none of the RTA covered in this study is found to be net export creating, more than one-third of the associates of RTA are found to be affected positively by joining the RTA.

Therefore, the declaration of a powerful effect of trade liberalization policies on export performance has remained unsettled in the economic literature. The impact depends on specific conditions of the economy on which trade liberalization may lead to promote export performance. Some studies have established a positive association between trade liberalization and export performance [Ahmed (2000), Dijkstra (1997), Joshi and Little (1996), Michealy, et al. (1991), Niemi (2001), Santos-Paulino (2000), Thomas, et al. (1991), and Weiss (1992)]. Some other studies verified the evidences to maintain the correlation [Agosin (1991), Clarke and Kirkpatric (1991), Greenaway and Sapsford (1994), Moon (1997), Morrissey and Mold (2006), Shafaedin (1994) and Utkulu et al. (2004)].

Alam (2016 or 2015) investigates the effect of trade liberalization policies on Pakistan's export performance by employing bilateral trade data across export market destinations. For this purpose this note reviews the trade policies of Pakistan for various periods and different episodes of trade liberalization process. To boost sectoral exports performance the WTO Trade Policy Reviews for Pakistan is further discussed by taking into account the several measures of trade liberalization and policies. In addition, the note presents scrupulous descriptive analysis of the World Bank's Exporters Dynamic Database [Cebeci, et al. (2012)]. This ;helps to understand the details of bilateral export, numbers of exporters, entry and exit of exporters across the destination markets and diversification/concentration of exportable products, such as Herfindahl Herschman Index across destinations and number of HS6 products per exporter transversely each destination market. Moreover, the study further investigates empirically the effect of trade liberalization in conjunction

with other influencing factors on Pakistan's export performance, particularly the role of FTA/PTA to enhance the Pakistan's export growth. For this purpose the study analysis export performance at different margins, such as, bilateral values of export, number of bilateral exporters and number of products across export markets. This analysis examines whether the impact of trade liberalization policies on bilateral values of exports, number of bilateral exporters and number of products varies across export markets especially across PTA/FTAs.

III. Evidence of Trade Agreement

This section presents a brief review of the selected studies on the effect of trade liberalization, particularly about the effect of free trade and preferential trading arrangements on export growth. It also shows the modelling approaches used to measure the effects of trade liberalization, especially the effects of FTAs and PTAs on export performance. When estimating the effects on trade patterns most economists and scholars use the gravity model because it is a tractable and flexible way of modelling bilateral trade flows.

Trade integration plays a crucial role to increase trade flows between the member countries. The number of FTAs and PTAs have rapidly increased during the current decade, across various developed and developing countries in different geographical regions. Many studies in the trade literature discuss the trade integration between North-North, North-South and South-South regions, which benefits from trade integration among developing and developed countries, and the modelling approaches used to examine the effect of FTAs/PTAs on bilateral trade flows among member countries. According to this background, the gravity equation is the most popular tool that measures the effect of free trade agreements on bilateral trade flows. Some previous studies find mixed and inconclusive results, such as Abrams (1980) and Frankel, et al. (1995), while recent studies present facts that FTAs/PTAs raise the bilateral flows between associate countries significantly [Baier and Bergstrand (2007)]. However, it is not obvious that increase in trade flows is similar in developed and developing member countries. According to Krugman (1991) and Magee (2003), "the developing countries are un-natural trading partners because of their alike comparative advantage, similar type of endowments, limited economic sizes and higher trade costs". These facts suggest that increase in trade flows is limited in the results of South-South agreements. The other dimension of South-South agreement is that developing countries could contribute demand for comparable products and could receive more striking concessions from the other developing countries, as compared to developed countries [UNCTAD (2007)].

Several studies, such as Cernat (2003), analyzing the effect of regional trade agreements particularly in South-South context investigates the effects of seven South-South trade agreements (AFTA, Andean Community, CARICOM, COMESA, ECOWAS, MERCOSUR, SADC) flows among them and finds a considerable

amount of trade creation between them. Similarly Mayda and Steinberg (2006) 2007 examined the impacts of COMESA on Uganda's trade flows and discover a little but positive impact on trade creation. Lee and Shin (2006) also illustrate a strong empirical proof for intra-bloc trade creation for different East Asian agreements.

The literature focusing on North-South trade agreements contain Trefler (2004) who examine the effect of North American Free Trade Area (NAFTA) on Mexico's trade and found positive and significant effect of NAFTA on Mexico's trade. While Pacheco-López (2003) estimates the effect of trade reforms (introduced in 1985-87) on Mexico's exports, imports and balance of payment. Pacheco-López also examines the effect of North American Free Trade Agreement (NAFTA) on Mexico's trade. The results of the study show that during the period trade reforms had considerable effects on exports, imports and balance of payments; while the Mexico's trade was not affected by implementation of NAFTA, significantly. Some other studies such as Anson, et al. (2005) and Carrere and de Melo (2004) revealed that Mexico has limited trade with USA due to restrictive rules of origin.** Cieslik and Hagemejer (2009) estimated the EU-MENA trade agreement and discovered that exports increased from EU to MENA but not in the reverse direction.

Another study by [Turkson (2007)], on North-South preferential trade agreements evaluates the effect of the European Union-African Caribbean Pacific Preferential Trade Agreement (EU-ACP PTA) and the sub-regional regional trade agreements (RTAs) on bilateral flows among 48 Sub-Saharan African and 25 European Union countries. The study uses a multiplicative gravity model for panel data of bilateral trade flows for the period 1960 to 2006. The study employs a fixed effect and Hausman-Taylor estimator and finds that PTAs and RTAs between Sub-Saharan African and European Union Countries have considerably enhanced export performance of member countries. Caporale, et al. (2008) model the effects of FTAs between the European Union (EU-15) and the Central and Eastern European countries (CEEC-4, i.e., Bulgaria, Hungary, Poland and Romania) on trade flows. The fixed effect vector decomposition (FEVD) technique is applied to deal with the possible endogeneity of the agreement variable. The estimated model show that FTAs increased trade between member countries. The results are robust to the addition of control countries (Belarus, the Russian Federation and Ukraine) to the sample that were not members of FTA.

Martinez-Zarzoso (2003) assesses the factors influencing bilateral trade flows between 47 countries, especially the impact of preferential trading agreements among various economic blocs and regions, such as European Union (EU), Caribbean Community (CARICOM), Centro-Amerian Common Market CACM), North American Free Trade Area (NAFTA) and other Mediterranean countries (MEDIT).

**Estevadeordal and Suominen (2004) established a measure of restrictiveness of rule of origin through the gravity equation and confirm that this rule weakens he trade between member countries.

This study uses an extended gravity model to determine the effects of gravity factors as well as preferential trading agreements on bilateral trade flows. The results of this study revealed that preferential trading agreements have a positive impact on bilateral trade flows and expand trade among economic blocs and countries significantly.

According to Ethier (1998) and Krueger (1999) "Southern countries are expected to play better role in North-South agreements than the agreements among themselves" because developing countries have similar endowments, and small economic size higher trade cost and comparative advantage for same type of products. While North-South agreements join together those countries which have different endowments and factor proportions. Moreover, through these agreements developing countries can enter in more developed markets. On the other hand, when agreements are between countries with unequal bargaining power, the trade is not welfare enhancing [Panagariya (1999)] because of the formulation of schemes and rules by high income countries. The low income countries have to implement their rules in spite of whether these rules are suitable to them or not. Therefore, in North-South agreements the advantage of low income countries is limited [Whalley (2003)]. Conversely, South-South agreements are expected among similar type of economies, which have similar level of development and competition.

IV. Conclusion

In light of the preceding discussion about trade integration among North-South and South-South trade, it is concluded that through government agreements developing countries do not receive much benefits AS comp;ared to the developed countries. T;his is due to unequal bargaining power of the developing countries. Moreover developing countries suffer by low economic size, resource miss-management, lack of research and development, to produce innovative products, they are also exploited by the higher income group countries and they have no option but to trade with the developed countries. For this purpose they should develop a large group of developing countries to integrate trade and economic activities, like European Union (which consists of 28 European countries) and other economic and trade integrations among the developed countries. On the other hand, developing countries can gain a benefit through integration with developed countries, i.e., they may obtain advance technologies and learn more from the advanced countries experience.

As the argument of Ethier (1998) and Krueger (1999) "Southern countries are expected to play better role in North-South agreements than the agreements among themselves". They imply that developing countries would obtain more benefits if they have an agreement with developed countries, as compared to the agreement with another developing country, because they have similar types of endowments

and their alike comparative advantages with same type of products. Developing countries, even with their similar endowments and small economic sizes should trade with each other too by reducing trade barriers (reducing trade costs) and produce innovative products to gain comparative advantage and compete to regional and international markets.

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