ANALELE ŞTIINŢIFICE ALE UNIVERSITĂŢII „ALEXANDRU IOAN CUZA” DIN IAŞI
Tomul LII/LIII Ştiinţe Economice 2005/2006

DETERMINANTS AND EFFECTS OF ECONOMIC OPENNESS

LĂCRĂMIOARA DOMINTE [*]

Abstract

International trade cannot exist without the economic openness of the countries involved. The process in itself is hard to be captured in definitions because it implies aspects related to external trade, exchange rate evolution or macroeconomic policies. The present article first concentrates on a short definition of the concept of economic openness. Then we focus the attention on some economic factors that may conduct to the economic openness of a country, such as: exchange rate volatility, input endowments or level of technology. The last part of the paper is allocated to presenting few positive and negative effects of opening towards the mechanisms of the world economy, followed by some concluding remarks.

Key words: economic openness, trade openness, trade liberalization, open economy, international trade, exchange rate volatility

1 Introduction

World economy cannot exist without the interdependences of the states. This fact is proved by more or less advanced processes of regional integration, in which cases, the vulnerability coming from „negative” imports is balanced by a significant plus of productivity and competitiveness, drawn from international trade. Following this interpretation, economic openness refers to trade relations with reduced or eliminated tariffs and non-tariff trade barriers. Their effects are pictured in the balance of payments, reflecting the involvement of a national economy in the world frame. On one hand, the exports illustrate the penetration of internal products on foreign markets. Their structure indicates the national stage of economic development. On the other hand, the imports create opportunities to accumulate upper quality resources that sustain the economy. These movements of goods, services or capitals are complementary, leading to a healthy economic growth.

2 Determinants of economic openness

As seen above, economic openness -generally considered trade liberalization- is a vital condition for the creation of a favourable position on international markets. That is why different degrees of openness may explain the variation of economic growth of countries, due to several determinants.

Among the first to be mentioned is the *evolution of the exchange rate*. Its volatility may affect the volume of trade, by diminishing the exports and increasing the imports, or

[*] PhD student, Department of Political Economics, Doctoral School of the Faculty of Economic and Business Administration, „Alexandru Ioan Cuza” University, Iaşi

vice versa. With the assumed uncertainty, the country manages to interact with the rest of the world, having access to new inputs or partially covering the external demand. In literature these two aspects are very often used to measure the degree of economic openness in the simplest manner. Authors refer to the ratio of total value of external trade in the national product as main indicator [Yanikkaya, 2003, 62].

Tightly correlated to the trade in goods and services appears the *distribution of production factors.* Different input endowments have a direct impact over the level and the diversity of internal production and over the quality exportable goods. The countries rich in strategic resources would generate an increased potential demand coming from less endowed states. On the other side, a poor country would direct the imports to the markets of abundant countries. A typical example, often mentioned at this point, is the relationship between industrialized and less developed countries. Exchanges of this kind have, in a certain dimension, a win-win character.

In addition, the developing countries gain benefits from *technology transfer.* Opening their economies, the access to an extended base of knowledge increases their internal level of productivity. This process is facilitated via international trade as main channel of innovative technology transmission, determining imitation or implementation of foreign know-how in national production stages. These actions may further increase the quality of supply on the market, lead to creation of new products adapted to new niches, improve the competitive position in an exigent business environment [Wacziarg, 2001, 397].

All these determinants can be regrouped around *transaction costs*. At the crossroads of transport spending, input supply and innovative production systems, these costs may also be shaped by the commercial distance between trade partners, the national currency's purchasing power, capital accumulation or telecommunications. Therefore, an increased liberalization of these areas will lead to a higher economic openness, pictured in internal economy growth.

Thanks to *multinationals* that manage to create an inspired connection of all costs related to international trade, the degree of openness can be increased through their activity on various economic territories. They use portfolio or direct investments as decisive instruments of superior quality exports orientation, carrying international credibility. The presence of multinationals in potentially productive sectors represents some sort of credit given to that national economy's efficiency, inviting other investors to join in.

Further widening the impact area of the determinants, nowadays the *participation in a regional agreement* indicates obviously the degree of openness of a national economy. Deepened integration of the member states shows their increased liberalization, yet only towards the states that are part of the regional group. The rest of the world is approached mainly on a protectionist basis [Belke and Wang, 2005, 2].

3 Effects of economic openness

Once the determinat factors (partially) indentified, we find necessary to point some effects generated by economic openness, in an either positive or negative light.

3.1 Positive effects

Trade openness via reduced or eliminated tariffs and non-tariffs barriers creates the premises for *national economic efficacy*, with an improved factor endowment among countries, directly reflected in the level of incomes.

Applying liberalization to capital account too, restrictive measures on foreign capitals are eliminated, offering new *investment opportunities* to external economic agents. These additional resources may latter finance eventual trade deficits that can occur from imports operated by foreign subsidiaries located on national territory.

On the long run, this implantation of foreign companies in the domestic economy would also *attract new technologies*. Then the labour productivity would increase, having a double effect. The competitiveness of local firms would improve, determining an increase of the exports that transmit the same effect to income levels [Vos et al., 2002, 125].

3.2 Neggative effects

Yet, economic mechanisms don't have just positive externalities. Therefore, economic openness respects the pattern, bringing costs too.

For example, the countries which have a significant comparative advantage in international trade face the *danger of innovative over saturation*. On long term their economic openness might cause productivity reduction. Innovations can turn into usual inputs if no investments are made in continuous up-grading, according to market evolutions.

By changing the angle, an increased economic openness may press national government to focus on the protection of the domestic producers confronted with external shocks. *State subsidies* provoke distortion in resource allocation, hurting the domestic growth. For the situation of membership in a regional trade block, such initiative negatively affects the internal market, blocking the access on certain markets for other companies originated in other member countries.

4 Concluding remarks

After the short review of the factors that lead to economic openness, and by balancing some positive and negative consequences of the phenomenon, some conclusions can be drawn:

- Economic openness means more than liberalization via reduced or eliminated tariffs or non-tariff barriers in international trade, as the gradual involvement of various parts of the economy gives a macroeconomic shape to the entire process;
- An increased degree of openness can be quantified both through intensive trade relations and competitive contribution on markets that have potentially increasing returns of scale due to their extended dimensions ;
- The complementarity between outward oriented trade policy and other domestic economic policies ensures a better macroeconomic management.

References

Yanikkaya, H., „Trade Openness and Economic Growth: A Cross-Country Empirical Investigation", *Journal of Development Economics*, No. 72, 2003.

Wacziarg, R., „Measuring the Dynamic Gains from Trade", *The World Bank Economic Review*, Vol. 15, No. 3, 2001.

Belke, A., Wang, L., *The Degree of Openness to Intra-Regional Trade Towards Value-Added Based Openness Measures*, Hohenheimer Diskussionsbeiträge, Institut für Volkswirtschaftslehre, Universität Hohenheim, Stuttgart.

Vos, R., Taylor, L., Paes de Barros, R*., Economic Liberalization, Distribution and Poverty. Latin America in the 1990's*, Edward Elgar Publishing Ltd., Cheltenham, 2002.