

# Economic and Social Effects of Opening

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## Abstract

The opening is necessary, but not sufficient, it helps provide remedial opportunities for developing countries by providing the means for poor countries to get out of underdevelopment, but on the other hand it makes them incur costs and risks. Our study conducted for the case of Tunisia showed that the opening will increase inequality, if it is not accompanied by control policies against disparities. This paper shows that the Atkinson index evolves in the same sense as the unemployment rate and the share of exports in Gross Domestic Product. Whereas, research and development expenditures, investment and human capital negatively act against rising inequality.

Therefore, we will have to question about the nature of the opening that allows developing countries to take advantage of opportunities with minimum costs. So in order to be relevant, the opening must be prudent, diversified, solid and reciprocal.

**Key words:** Inequality, Opening, Polarization, human capital, Specialization.

**JEL Classifications:** D63, F15, D31.

## Introduction

The rapid opening of economies to the world can keep underdevelopment to the countries of the South who are often unprepared to compete internationally, despite the encouragement of international financial institutions. This paper pays particular attention to two research tracks, the first highlights the different economic risks of opening based on the phenomenon of polarization and specialization while the second focuses on the social risks with regard to the increase in inequality.

Openness to the world economy is beneficial for some countries and not to all, since it is likely to make the rich richer and the poor poorer, Globalization can thus be a key element of inequality, which is opposed to the idea that the problems of developing countries are generated only by internal causes and also contradicts the economic theory that defends globalization by granting it a phenomenon of convergence between rich and poor.

## I-Economic risks of opening

Even broadly favorable, integration may increase the divergence when the least developed countries are more affected by diversions than the most developed countries. This

divergence is likely in case when the lagging countries adhered to a free exchange zone already established and large size. It therefore appears that the size effect is the first divergence factor which acts negatively on the effects of diversion, the second factor is the asymmetry of power relations that enable countries constituting the free trade area to keep protections of some products. This, limits the trade creation effects in other countries.

Thus, in order to clarify the causes of the divergence we are interested in two effects: those of polarization that grow to agglutination of activities in already developed countries and the effects of specialization that contribute to limiting the least developed countries in the less dynamic activity.

Although the basic features of globalization are no longer contested, opinions differ as to its effects on the inequality between poor and rich regions, on this point, economic geography provides interesting studies based on the concept of divergence between countries, dividing the world economy between poor and rich countries of the center. Indeed, this economy aims to demonstrate that the costs of trade are not equally distributed among the different countries as this is the periphery where localize poor countries who bear the costs of globalization and therefore the benefits of opening will not be easily achieved.

Within economies poorly endowed with natural resources, convergence is carried out through an improvement in the industrial sector, in this context the polarization effects of activities in this sector can offset those of delocalisation encouraged by low wages and high relative remuneration of capital, this argument was justified by Krugman (1991) and Krugman and Venables (1996).

Moreover, public opinion in the developed countries has often stated that delocalisation will benefit the least developed countries where labor costs are lower compared to other, while the least developed countries dread being occupied entirely of imported industrial products of other countries.

Theoretically, based on the contribution of neoclassical economics, convergence is related to diminishing returns in capital, however, when the effects of scale offset the diminishing returns of capital, integration will attract capital in the more developed regions that will benefit from new gains of scale. If increased capital intensity does not imply declining relative return on capital according to the neoclassical theory, but instead generates increased remuneration of all factors, integration will provide support to an emigration movement of capital and labor from less advanced countries to the most advanced country, this polarization may therefore reverse the equalization theorem of factor prices, thus, the integration will not lead to a convergence of wages but to will be the cause of divergence.

Similarly, economic geography emphasizes the importance of the distance from the periphery to the center designed as a determinant of inequalities between countries, since the costs of this distance including the looking for a partner, transportation, time to exchange ... are fully supported by the periphery. Thus, the distant countries to center are obliged to pay the cost of the distance, which still impoverishes and strengthens its divergence from the center of the country, this theory is based on a pessimistic view on the reduction of international inequalities.

Economic geography also explains the dispersion between the center and the periphery on the basis of inequalities in remuneration of production factors. Accordingly, the income will be lower in the periphery, given the costs of the distance separating the center. Among the studies that highlight the negative implications of distance on the inequalities we cite the research of Venables (2001).

On the same basis, interested in the particular case of the United States, Krugman (1991) distinguished an industrial East, and an agricultural West, he actually assumed the existence of a producer of many industrial goods and a traditional sector specializing in a homogeneous good submitted to the non-increasing returns. The distance produced a favorable effect on the relocation because it encourages local production, however, this effect is mitigated by the differentiation of demand and thus by the nature of potential intra-industry trade between industrial areas and other agricultural.

Similarly Krugman reported that the stability of the industrial polarization in the center is assured by increased spending on industry, the reduction in transport costs and the importance of economies of scale. Several criticisms were addressed to the Krugman model based on the fact that it is applicable for countries that differ in their production structures. Several criticisms were addressed to the Krugman model based on the fact that it is applicable for countries that differ in their production structures but similar in their level of development.

However, the consideration of an assumption of labor immobility can camouflage migratory effects of integration in the sense that the need of catch-up in the productive sector is clearly expressed in agricultural areas, the consideration of these migration effects may increase the effects of polarization.

The second line of research of economic geography was next to the one based on the implications of distance is that based on the effect of lower transport costs lower transport costs created by the opening on the polarization and specifically on the dispersion and divergence between countries.

In this context several economists have questioned whether the reduction of transport costs is beneficial to the periphery, according Venables (2001) must not be satisfied with this reduction because the opportunity cost of time does not diminish and even if there will be a rapid coverage of distances, it will necessary to be more responsive to market changes and therefore closer to thereof. It follows that with the development of transportation, activities should not be dispersed because in spite of the dispersion, they will be affected by competition, hence the decrease in transport costs between regions can cause South deindustrialization.

The above argument was advanced by Krugman and Venables (1995) suggesting that in a first stage inequality is growing seen by lowering transport costs below a certain threshold, the countries that are peripheral undergo decline in real incomes and it is only with the continuation of this decline as there is a possibility of convergence between the two categories of countries.

Krugman and Venables (1995) assumed that the North produces manufactured goods of two types: final and intermediate and South specializes in agricultural goods, they assumed that at the first stage the North has a production of finished goods slightly higher which requires

more intermediate goods, enterprises in these goods therefore prefer to settle in the North where the profits will be higher.

So there will be in the North, a greater variety of intermediate goods, thus reducing the cost of production of final goods and encouraging of manufactured goods companies to localize in the North. Faced with this location in the center, the south eventually industrializing while the North produces more final goods which will strengthen the divergence and the already existing inequalities. Indeed, economic geography provides a critical view to opening process stating that declining trade costs is not automatically beneficial to the periphery.

In this context Petitjean (1999) is of the same opinion as Krugman and Venable (1995) arguing that in the first instance, globalization increases inequalities between regions by dividing the global economy between the poor countries of the periphery and rich countries of the center and secondly, as the integration with the global economy intensified, appears a movement of convergence of income and economic structures. It shows that the globalization of markets does not necessarily lead to the equalization of factor of production income, so when transport costs remain high, it aggravates inequalities between countries and the convergence process appears only if the level of transport costs sufficiently diminishing.

Consequently, free trade remains the optimum long-term in line with the traditional economic theory, however, leading to free trade, all countries do not enjoy the same favorable treatment as globalization could hinder in its initial phase, the economic development of countries whose characteristics are not advantageous.

Similarly, in order to explain how globalization, characterized by the increasing openness of the country to international trade, it is responsible for the inequality of wealth and more broadly, the growing differences in living standards between countries, we point out that in addition to strengthening the polarization, specialization and limitation of countries in special goods can be risky by the opening.

In a context of trade openness, country specialization focuses on the goods they produce most efficiently relative to their trading partners, in fact, it is the classical theory of comparative advantage, according to this theory, trade is always beneficial for all countries, it generates the complementarity and not the competition. The inequality problem has no interest with this theory, which predicts that trade as a whole is positive, whereas with the context of inequality, international trade has different effects in countries.

The standard theory of international trade promotes equivalence of sectors in terms of growth prospects with traded goods in perfectly competitive markets, while the new international economy and of endogenous growth take into account the existence of a little intensive sector in non-increasing returns to scale and another modern sector benefiting from increasing internal and external returns to produce differentiated products with high level of technological development. External economies generated by these sectors enable increasing productivity and living standards, thus promoting the accumulation of human capital.

Furthermore, the integration of countries with unequal levels of development promotes intra-industry based on products with different qualities exchanges, which could polarize activities, so since the incorporation of the quality is positively related to per capita income,

the integration eventually guide the specialization of least developed countries towards low-quality products with lower returns.

Accordingly, the imposition of a specialization for a country can be harmful economically, it will instead be a specific choice of the country itself. It follows that in addition to exogenous determinants, specialization results of the behavior of agents, public policies or business strategies and it can never be imposed on a country. Specialization, must, however, be achieved on the basis of global demand of good as the country's interest to focus more attention, so this good is valued internationally.

In this context, emerging countries must free themselves from the production of primary products, whose value relative compared to traded goods is reduced, they must specialize in manufacturing goods. So, it comes to creating an enabling comparative advantage of industrialization and development. Similarly, developing Countries should consider that the opening may have social costs and must involve policies against social inequality with the integration into the global economy.

## **II- Social risks of opening**

Market liberalization associated with globalization should accelerate economic growth by improving productivity. However, many economists fear that the search for efficiency is being at the expense of equity in developing countries, in this context, an inequality between workers may be held only if the most qualified exhibit an adaptability to new technology.

Indeed, studies that are concerned with gains made following the opening must consider its effects on income distribution. Thus, in many developing countries opening generates economic growth simultaneously with a strong increase in inequalities. At this level, rising inequality offsets the increase in income and the situation of the poor is worsening, despite the gain brought the country. Meanwhile, other studies defend the opening by advancing that it may be advantageous mainly for those who have a state capable of accompanying the opening process by appropriate internal policies. Thus, the coexistence of these hostile thoughts led to important debates between those who are in favor of openness and those who are against.

In this context, Milanovic (2002) found an increase in internal inequalities by referring to the Theil coefficient, likewise, Giraud (2000, 2002) deals globalization of a phenomenon with double effect, positive and negative. The positive effect results in the acceleration of growth and investment, while the negative impact of globalization leads to an increase in internal inequalities saw the uneven distribution of benefits within the country. Nasfi (2013, 2014) has likewise proved an income distribution increase for the case of Tunisia and strengthening regional disparities within the country.

Other studies were based on the process of creative destruction in order to explain the internal inequalities. Thus, Aghion and Howitt (1994) showed that with the spread of new technologies, job destruction will be considered, given the non-use of human effort in the production process. Thus, with the industrial computerization, only the most skilled will benefit, there will be an increase in inequalities between those who benefit and those who have not

been able, so its differences come from a biased technical progress for more competents. In this context we mention the research of Barro (1999).

Based on different reasoning, Nicita (2004) studied the effect of openness on inequality via prices, the author sought primarily the impact of the opening on price and then the price impact on inequality. In fact, despite its positive effect on growth, trade liberalization has amplified the disparities that existed in developing countries, the coexistence of these two contradictory effects provoked considerable debate and highlighted the need for new development policies focused on reducing inequality and poverty.

So, faced with rising inequality within developing countries, many governments have adopted policies to fight against these inequalities to minimize social conflicts and remove barriers to growth, in this context, the remedies to inequality by redistributive policies must integrate disadvantaged groups of the population in the economic and social life.

### **III-Empirical study**

The empirical study relating to this paper is to give special attention to Tunisia to identify the nature of the relationship between trade openness and inequality between workers. To do this, we rely on the following variables :

AT: Atkinson index of inequality of wage distribution.

UN: Unemployment rate.

IV: Investment as percentage of GDP.

OP: Share of exports in GDP.

ET: Enrollment at tertiary level.

RD: Research and development expenditures as a percentage of GDP.

With these variables we estimate the following equation:

$$AT = C + \beta_1 UN + \beta_2 IV + \beta_3 OP + \beta_4 ET + \beta_5 RD$$

To ensure the stationarity of the variables, we use the unit root test, the test showed that the variables are stationary at 1% significant level. The study was conducted for the period 1990 - 2012, the results for the estimation are presented in the following table:

Table 1. Estimation Results

<b>Variables</b>	<b>Coefficient</b>	<b>t-statistic</b>
C	0.392	2.778
UN	0.766	2.252
IV	-0.667	-5.401
OP	0.598	2.746
ET	-0.138	-2.408
RD	-0.132	-3.889
R-squared	0.895	
F-statistic	28.3	

Econometric estimation through the Eviews software shows that in this model two variables contribute to the increase in inequality, these variables are unemployment and openness. Thus, the increase in exports will have a double effect on the economy, he may initially have positive effects on the growth of countries, but this effect was quickly rewarded with another negative, affecting the distribution of income, in this context an aggravation of inequality will occur. Moreover, it is alleged that a number of developing countries including Tunisia to be interested in improving productivity and growth without regard to equity and regional distribution which caused the Tunisian revolution of 2011.

Thus, it is recommended to Tunisia to fight against inequality and to focus on the variables that affect it negatively. Besides, our econometric estimation shows the necessity of using increasing investment and improving the level of knowledge of individuals with the use of education and human capital investment. The sign of these variables is negative in our model showing that they are able to decrease inequality.

It appears from this study that the opening designed for Tunisia must be prudent, diversified and solid. Indeed, despite the positive contribution generated by the integration into the world economy, temporary protection of some markets may seem effective. Thus, with increasing returns from such a long experience of production, the producer must ensure that its market share is higher than that of competitors saw his advantage cumulative competitiveness, and it is important to take advantage of the initial benefit, which explain a temporary market protection.

An economy can also follow introverted policy for some time in order to gain experience and therefore be competitive at the time of opening, this strategy should be adopted to not confront the same good from outside and produced with production costs lower than domestic.

In this context, it is important to take more interest in the opening moments and not in the decision of its adoption as economic policy.

Similarly, developing countries need to diversify their exports and thus their specializations to reach stable and generators sectors of growth. To do this these countries must take advantage of new information and communication technologies. These are designed as a development accelerator as they act directly on the human capital available to a country through the Internet which allows the exchange of knowledge and rapid dissemination of technical progress. What contributes to improving the level of training and information of the population and adds value to local resources. These technologies will therefore be able to boost the internal market for developing countries.

Meanwhile, the transparency of information contributes to a better understanding of global demand which reduces the burden of intermediaries between consumers and producers. Similarly, information technology and communication can promote the growth of developing countries since the introduction of advanced communications infrastructure is a prerequisite for attracting foreign investment and implementation of large foreign companies.

However, another line of research considers that the new information technologies merely maintain the global imbalance between countries according to the theory of economic geography. This theory sees in the reduction of transport costs, a cause of the maintenance of inequalities since countries do not benefit to the same extent. Therefore, taking into account the negative contribution of new technologies to the reduction of inequalities, however, we can count on them as they allow developing countries to take into account the existence of the least developed countries.

In the same context and to take advantage of the opportunities offered by liberalization, a country must accompany good regulation and appropriate internal policies, which requires a state capable of controlling the opening process and ensure good governance. However, the idea put forward should not obscure the consideration of country capacity, in the sense that in the absence of its capabilities in infrastructure, human capital ... good regulation will be powerless to strengthen the opening. On the same basis and in order to achieve the same objective, which is the improvement of fates of developing countries through beneficial integration minimizing risks and costs, the opening must be reciprocal.

## **Conclusion**

The objective of this paper is to pay particular attention to the economic and social risks of opening. Our econometric estimate was based on the Atkinson index that we have calculated, spending on research and development, investment, human capital, openness and the unemployment rate. The study showed that it is the investment, spending on research and development and recourse to improving human capital that reduces inequality.

Indeed, given the risks of opening worn on a bad specialization imposed in a non-productive sector or a polarization phenomenon of the country, which weakens the regions compared to others, Tunisia and the developing countries should be cautious about this opening to be able to achieve a surplus and capture the benefits of integration into the global economy, which leads to suggest that the opening must be prudent, diversified and solid.



The impact of trade liberalization on the dispersion of living standards between countries or between individuals has aroused obvious interest among theorists of international trade and inequality, about that opinions differ between those who see in the opening catch-up opportunity and others who accuse it of strengthening existing disparities.

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