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Globalization, rent protection institutions, and going alone in freeing trade

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ABSTRACT

We construct a two-country North–South Product-cycle model of trade with endogenous growth and trade barriers. We remove the scale effects on growth by incorporating rent protection activities by Northern incumbents. We examine the effects of two forms of globalization – an expansion of the relative size of the South and unilateral trade liberalization by either country. We find that the location of rent protection institutions and the sectoral trade structure determine whether or not globalization raises steady-state economic growth. We demonstrate that for accelerating worldwide economic growth, contrary to conventional wisdom, unilateral Northern trade liberalization is preferable to bilateral trade liberalization.

1. Introduction

The past two decades have been marked by the entry of large developing countries, such as Argentina, Brazil, China, Egypt, India, Turkey, Poland and Romania into the world trading system. As shown in Fig. 1, between 1990 and 2002 the world trade share of middle-income countries has increased from 15 percent to 22 percent. During the 1983–2003 period, China as the world's most populous country has increased its share in global trade from 1.01 percent to 5.04 percent.

Moreover, during the eight GATT negotiation rounds from Geneva 1947–1948 to Uruguay 1986–1993, the average tariff rates among participants declined from 52.7% to 13.1% of the 1931 level, as shown in Table 1. From earlier to later rounds, the number of participants increased significantly, mainly due to developing countries joining the GATT negotiations.

With more developing countries establishing international trade linkages and pursuing freer trade policies, these globalization trends are likely to continue in the following years.

Is 'globalization' good for economic growth? We analyze this question theoretically in a general-equilibrium North–South Schumpeterian growth model with a continuum of high-tech industries.[1] Northern entrepreneurs participate

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[1] The empirical evidence on the trade-growth nexus is mixed: while the majority 'optimistic' view is that, mostly based on the Sachs–Warner criteria for openness, trade raises growth (see e.g. Lewer and Van den Berg, 2003; Wacziarg and Welch, 2008; Winters, 2004; Noguer and Siscart, 2005), other

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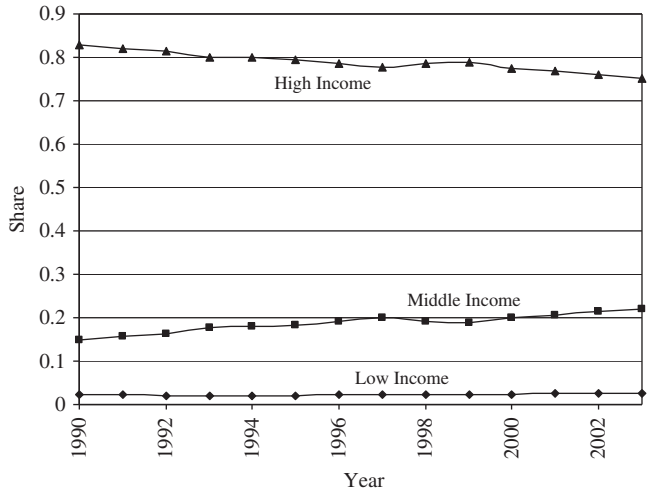

Fig. 1. World trade share of country groups. *Data Source*: World Bank (2005). For each country group, world trade share is imports plus exports of goods and services measured in current US dollars divided by the corresponding value for the world. Income divisions, which follow the World Bank classifications, are based on 2003 gross national income per capita levels: $765 or less for low-income countries; $766–$9385 for middle-income countries (including China); $9386 or more for high-income countries.

Table 1
Tariff reductions during GATT and WTO rounds.

Round	Number of participants	Average % cut in all tariffs	Average tariff level as % of 1931 level
Geneva, 1947–1948	23	21.9	52.7
Annecy, 1949	13	1.9	51.7
Torquay, 1950–1951	38	3.0	50.1
Geneva II, 1956	26	3.5	48.9
Dillon, 1960–1962	26	2.4	47.7
Kennedy, 1964–1967	62	36.0	30.5
Tokyo, 1973–1979	102	29.6	21.2
Uruguay, 1986–1993	123	38.0	13.1
Doha, 2001–?	141[a]	?	?

Sources: Van den Berg (2004), Table 8.1, p. 278; Neary (2004), Table 1, p. 321; www.wto.org.
[a] 141 at the start, 149 at Hong Kong Conference, December 2005.

in R&D races to innovate higher quality consumption goods. Southern entrepreneurs compete to imitate the current Northern production technologies. In each industry, the winner of the R&D race establishes temporary monopoly power until driven out of the market by further innovation or imitation. Global economic growth is driven by the continuous arrival of higher quality goods through Northern R&D races. During their tenure, Northern monopolists engage in Rent-Protection Activities (RPAs) to safeguard their monopoly profits.[2] RPAs encompass all activities that deter the innovation and imitation efforts targeted at the incumbent firm (such as patent enforcement, practicing trade secrecy, and lobbying the government to promote stronger intellectual property rights protection). Northern innovation and Southern imitation rates are determined endogenously. With lower production costs in the South, successful imitation in a certain industry implies the shifting of production from the North to the South. This gives rise to North–South "product-cycle trade": the North exports newly invented goods that are not yet imitated, and the South exports imitated products. The governments in both the North and the South impose ad-valorem tariffs on high-tech imports.

(*footnote continued*)
researchers have important reservations on how the 'optimists' have derived and interpreted their results, and hence remain overall skeptic (see e.g. Rodríguez and Rodrik, 2000; Hallak and Levinsohn, 2008; Wälde and Wood, 2004). A recent thoughtful discussion of the potential of the Sachs–Warner criteria to measure the trade policy impact on growth is provided by Lucas (2009), who supports the 'optimistic' view.

[2] RPAs in an endogenous growth model are originally proposed by Dinopoulos and Syropoulos (2007). See Dinopoulos and Syropoulos (2007, pp. 310–312), Şener (2008, Footnote 20) and Scotchmer (2004, Chapter 7) and the references therein for detailed discussion and empirical evidence on RPAs in a closed economy setting. The available evidence suggests that patent enforcement by successful innovators is prevalent across all industries and costly to undertake. Many companies, especially small firms, cite this as a deterrent to their R&D success. Lobbying activities to influence the judicial and legislative system are also well documented in the literature.