Chapter 23
Impact of Trade Liberalization on Income Inequality:
Evidence From Turkey

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ABSTRACT

This study consists of trade openness in Turkey within the scope of the 1985-2018 period and examination of the cointegration and causality relationship between the Gini coefficient and per capita income levels. In this regard, per capita income, which is one of the economic welfare indicators, has been used as the control variable. ARDL boundary test models used in the analysis have been examined by forming two models in which both variables have been evaluated as dependent variables. Therefore, the short- and long-term effects of both variables on each other have been determined. The cointegration relationship tests performed within the scope of the ARDL boundary test in the first stage of the analysis showed that these variables act together in the long run. However, it has been determined that the trade openness ratio negatively affected income justice in the short and long term.

INTRODUCTION

Developing countries need to achieve higher and sustainable economic growth to close the development gap they have with developed countries. This situation has emerged the need for developing countries to acquire the sources they need during the economic growth period from developed countries. At this point, foreign trade comes up as an important alternative for providing the sources that the countries in question need. Countries try to enhance their economic performances and obtain a good way of financing

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through trade openness by means of providing access to the best technology that would help to increase competition and efficiency.

In recent years, the world has been experiencing rapid globalization due to foreign trade and foreign investments in economic activities along with witnessing an ever-increasing income inequality. It is seen that the countries that deliver a successful performance in terms of economic growth during the globalization process go through negative situations due to various problems such as increasing inequality and environmental problems, regarding the quality of economic growth. At this point, one of the subjects that have importance for people, society and governments is that countries achieve a fair and balanced growth together with sustainable economic growth. Otherwise, the increase in income inequality will cause social unrest and political instability, which will undermine the positive impacts of economic growth. In fact, the importance of reversing the increasing inequality trends in developing countries has been accepted and The United Nations included reduction the inequality in question in the system as one of the 17 sustainable development goals (Urata & Narjoko, 2017: 1).

One of the main issues discussed regarding the effects of trade openness on the economies of developed and developing countries along with the increasing globalization activities, is how trade openness affects the distribution of income. In this context, it is not possible to say that economists have reached an exact consensus about the effect of trade openness on income distribution (Dung, 2004: 2).

There are two opinions about the effect of trade openness on income distribution. According to the first opinion, foreign trade and foreign investments are secret devices of exploitation used by developed countries against developing countries. Thus, it is suggested that trade openness would cause bad economic growth known as "dual growth" that causes income inequality in developing countries (Dung, 2004: 2). The second opinion is based on the Stolper-Samuelson theorem. According to this theorem, trade openness would provide an opportunity for more rapid economic growth and a reduction in income inequality by getting comparative advantages in favour of unskilled labour (Wood, 1994).

According to the Stopler-Samuelson theorem, which derives from the Heckscher-Ohlin model, foreign trade would provide benefits to the relatively abundant factor of a country, as specialization in foreign trade would prefer sectors with abundant factors. In other words, when a developing country that has relatively abundant unskilled labour and consequently has a comparative advantage in the factor of production comes into question, trade openness increases the demand for unskilled labour and the price of this labour accordingly. Thus, this process turns the wage gap between the skilled and unskilled labour to normal and reduces the income inequality in the country. However, the Stopler-Samuelson theorem is criticised a lot due to its restrictive assumptions (Meschi & Vivarelli, 2007). In addition, it is revealed that globalization and income inequality generally appear together in developing countries, contrary to the Stopler-Samuelson theorem (Goldberg & Pavcnik, 2007: 39). According to this view, it is possible for middle income countries to be relatively unskilled labour abundant when compared to high-income trade partners and to be relatively skilled labour abundant when compared to low-income countries. Thus, one of the crucial consequents of this situation is that the demand for unskilled labour increases and the wage gap rises due to decrease in wages. By this way, it is seen that trade liberalization increases the demand for skilled labour in both developed and developing countries (Örnek & Elveren, 2010: 63). For example, Kremer & Maskin (2006) revealed that globalization did not consistently produce the expected Heckscher-Ohlin effect in reducing the income inequality in less-developed countries, according to the findings acquired as a result of applied studies (Kiyota, 2012: 656).

One of the assumptions of the Stopler-Samuelson theorem is that countries have the same technologies. However, the level of technology differs substantially in developed and developing countries. Transfer

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