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SMALL AND OPEN ECONOMIES IN INTERNATIONAL TRADE THEORY AND THE CASE OF BULGARIA

Abstract: The article examines the theoretical approaches to small and open economies within international trade theory and assesses their applicability to the case of Bulgaria. From a theoretical perspective, a small economy is defined not by its absolute scale, but by the absence of market power and the resulting inability to influence international prices, which positions it as a price taker in global markets. Economic openness is conceptualized as a structural characteristic reflected in deep integration into international trade and cross-border financial flows. While such openness expands opportunities for growth, specialization, and market access, it simultaneously increases exposure to external economic, financial, and geopolitical shocks. The article provides a systematic overview of the key characteristics, policy instruments, and structural constraints of small and open economies, distinguishing between theoretical definitions and the practical classifications applied by international organizations. Particular attention is devoted to trade policy, which in these economies is oriented not toward influencing world prices, but toward liberalization, diversification, trade facilitation, and integration into regional and global value chains. Within this framework, Bulgaria is examined as a representative case of a small and open economy. Its limited domestic market, high degree of trade openness, and deep integration into the European Union shape both development opportunities and structural risks. The article concludes that Bulgaria's sustainable participation in international trade depends on adaptive policies aimed at diversification, competitiveness, and the effective use of regional integration frameworks.

Keywords: small and open economies, international trade, trade policy, regional integration, Bulgaria.

Introduction

At the beginning of the twenty-first century, international trade has established itself as one of the key mechanisms through which national economies integrate into the global economy, allocate resources, and realize economic growth. Under conditions of deepening globalization, increasing interdependence of markets, and accelerated transformation of international specialization, the role of trade acquires particular significance for small and open economies. For them, international exchange is not merely a supplement to domestic production, but a structural necessity, without which sustainable development is practically impossible.

While large economies can rely to a significant extent on domestic demand, on large-scale internal markets, and on their ability to influence international prices, small economies are placed in a fundamen-

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tally different position. Their limited domestic market, modest productive capacity, and lack of market power in global markets turn them into price takers, strongly dependent on external demand, on global price fluctuations, and on the institutional framework of international trade. The openness of these economies, measured through the intensity of trade and financial flows, simultaneously expands opportunities for growth and increases their vulnerability to external economic, financial, and geopolitical shocks.

Against this background, the present article aims to systematize and synthesize the main theoretical approaches to the analysis of small and open economies, to examine their main characteristics and policies, and to assess the applicability of these concepts to the case of Bulgaria. Bulgaria represents a particularly relevant case, as it is a post-transition economy that combines small economic size with a high degree of openness and full integration into the European Union. The study does not set itself the task of carrying out an empirical analysis of the country's foreign trade flows, as its primary objective is conceptual clarification and theoretical interpretation rather than quantitative testing. Thus, the aims rather to interpret the structural characteristics of the Bulgarian economy through the prism of established and contemporary theoretical concepts, as Bulgaria is considered as an illustrative case of a small and open economy, whose development is closely linked to the processes of regional integration and global specialization.

The main thesis is that small and open economies operate under conditions of structural constraints arising from their scale and from the lack of market power, but at the same time they possess specific opportunities for adaptation through specialization, integration into global and regional value chains, and proactive participation in multilateral regional trade frameworks. Their successful positioning in international trade depends not on attempts at strategic influence over prices, but on their ability to diversify their trade partners, product structures, and policies within the existing institutional constraints.

Methodologically, the study is based on an analytical and comparative review of classical and contemporary literature on international trade, as well as on a synthesis of institutional analyses and empirical generalizations on small and open economies. Established theoretical models and concepts are used, complemented by examples from practice, which allow for a better understanding of the structural interdependencies and strategic choices facing these economies.

Rather than proposing a new theoretical model, the contribution of the article lies in the systematic synthesis of international trade theory on small and open economies and its structured application to the Bulgarian case, with the aim of clarifying policy-relevant implications under contemporary conditions of globalization and regional integration.

1. A Small Economy in International Trade Theory

From the point of view of international trade theory, the small economy is defined above all by the lack of market power in the global economy. In practice, this is an economy whose trade activities are too limited to influence international prices of goods and services. Such price-taking behavior is the cornerstone of the theoretical framework for small economies.[1, 2]

In classical models, such as Ricardo's framework of comparative advantages,[3, 4] the small economy can trade freely with the rest of the world at given world prices. In a similar way, according to the Heckscher–Ohlin model, which emphasizes differences in factors of production, a small economy will

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[1] **Krugman, P., M. Obstfeld, M. Melitz.** *International Economics: Theory and Policy*. 12th ed. Harlow: Pearson, 2022. Available at: https://archive.org/details/internationaleco0000krug_w8j3/page/n5/mode/2up?

[2] **Samuelson, P., W. Nordhaus,** *Economics*. 19th ed. New York: McGraw-Hill, 2009. Available at: https://studylib.net/doc/27741400/economics-19e-paul-samuelson-william-nordhauspdf-

[3] **Ricardo, D.** *On the Principles of Political Economy and Taxation*. London: John Murray, 1817. Available at: https://competitionandappropriation.econ.ucla.edu/wp-content/uploads/sites/95/1970/01/Principles-of- Political-Economy-and-Taxation-1817.pdf

[4] **Marks, R.** *The Origins of the Modern World: A Global and Ecological Narrative from the Fifteenth to the Twenty-first Century.* Bloomsbury Academic, 2007. Available at: https://www.scribd.com/document/680871454/Robert-B-Marks-The-Origins-of-the-Modern-World-a-Global-and-Ecological-Narrative-From-the-Fifteenth-to-the-Twenty-first-Century-Rowman-Littlefie

export goods of which it has a relative abundance and import those in which there is a relative scarcity, without affecting international trading conditions.[5, 6] The main result of this is that policy interventions such as tariffs or export subsidies do not change world prices.

Consequently, small economies cannot improve their welfare through strategic trade policies such as optimal tariffs, which require market power.[7, 8] On the contrary, the welfare of a small economy depends to a large extent on internal factors – resource endowments, technologies, and consumer preferences.[9]

In the literature, several defining characteristics of small economies in trade theory are identified:

1. Price-taker status – small economies take international prices as given and cannot influence them through political or production decisions.[10]

2. High degree of openness – such economies usually rely heavily on trade, with exports and imports representing a significant share of GDP.[11, 12]

3. Vulnerability to external shocks – as price takers, small economies are exposed to fluctuations in world prices and in demand for raw materials.[13, 14]

4. Limited scope of strategic trade policy – trade measures provide protection to local sectors but cannot influence terms of trade on a global scale.[15, 16]

The distinction between small and large economies is of decisive importance (see Table 1). Large economies such as the United States, China, or Germany possess market power and can influence international prices through policies or through changes in production and consumption. For example, a tariff imposed by a large economy can reduce the world price of imports, improving the terms of trade of the imposing country, while the same tariff imposed by a small economy simply increases domestic prices.[17, 18]

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[5] **Heckscher, E., B. Ohlin.** *Heckscher–Ohlin Trade Theory*. Cambridge, MA: MIT Press, 1991. Available at: https://archive.org/details/heckscherohlintr00heck/mode/2up

[6] **Samuelson, P.** International trade and the equalisation of factor prices. *The Economic Journal*, 58(230), 1948, pp. 163–184.

[7] **Krugman, P., M. Obstfeld, M. Melitz.** Op. cit.

[8] **Appleyard, D., A. Field.** *International Economics*. 9th ed. New York: McGraw-Hill, 2017. Available at: https://studylib.net/doc/27867313/international-economics--mcgraw-hill-series-economics----...

[9] **Bhagwati, J.** *Free Trade Today*. Princeton: Princeton University Press, 2002. https://doi.org/10.1515/9781400824342

[10] **Krugman, P., M. Obstfeld, M. Melitz.** Op. cit.

[11] **IMF.** *Macroeconomic Issues in Small States and Implications for Fund Engagement*. Washington, DC: International Monetary Fund, 2013. Available at: https://www.imf.org/en/publications/policy-papers/issues/2016/12/31/macroeconomic-issues-in-small-states-and-implications-for-fund-engagement-pp4745

[12] **WTO.** *World Trade Report 2022: Climate Change and International Trade*. Geneva: World Trade Organization, 2022. Available at: https://www.wto-ilibrary.org/content/books/9789287053961

[13] **Schiff, M.** Regional Integration and Development in Small States. *Policy Research Working Paper*, No.2797. World Bank, 2002. Available at: https://ssrn.com/abstract=634419

[14] **Guerrón-Quintana, P.** The Economics of Small Open Economies. Business Review, Federal Reserve Bank of Philadelphia, Issue Q4, 2013, pp. 9-18. Available at: https://www.philadelphiafed.org/-/media/frbp/assets/economy/articles/business-review/2013/q4/brQ413_economics_small_open_economies.pdf

[15] **Melitz, M.** Trade competition and reallocations in a small open economy. *Ing, L.Y., & Yu, M. (Eds.). (2018). World Trade Evolution: Growth, Productivity and Employment* (1st ed.). Routledge, 2018, pp. 60-81. https://doi.org/10.4324/9781351061544

[16] **Restrepo-Echavarría, P.** Closing Small and “Sufficiently” Large Open Economies with Different Asset Structures. Federal Reserve Bank of St. Louis Review, vol. 106 (13), 2024, pp. 1-8. https://doi.org/10.20955/r.2024.13

[17] **Krugman, P., M. Obstfeld, M. Melitz**. Op. cit.

[18] **Samuelson, P., W. Nordhaus.** Op. cit.

Table 1. Differences Between Small and Large Economies in International Trade

Characteristic	Small economy	Large economy
Influence on world prices	Price taker; cannot influence international prices	Price maker; can influence world prices. Tariffs/subsidies can change global prices; can improve terms of trade
Impact of trade policy	Domestic tariffs/subsidies affect only local prices; no improvement in terms of trade	Moderate vulnerability; market power allows some mitigation of shocks
Exposure to external shocks	Strong vulnerability due to dependence on world markets	May vary; may depend less on trade relative to GDP
Trade volume relative to GDP	Often high openness; trade constitutes a large share of GDP	Significant openness; can use strategic trade policy to influence global outcomes
Ability to use strategic trade policy	Limited; cannot gain from optimal tariffs or export subsidies	Important, but less critical; the larger domestic market provides a buffer
Need for diversification	Critical; strongly dependent on specific goods or partners	Can be both a hub and a participant; can influence the structure of chains
Participation in global value chains	In many cases through specialization in niche sectors	Strategic trade, industrial policy, global market interventions
Typical policy focus	Trade liberalization, diversification, regional integration, external cooperation	Price making; can influence world prices through policies or market changes. Tariffs/subsidies can change global prices; can improve terms of trade

Source: Compiled by the author based on Krugman, Obstfeld & Melitz (2022); Samuelson (1948); Samuelson & Nordhaus (2009); Bhagwati (2002).

Examples of contemporary small economies include Luxembourg, Malta, and Iceland, which illustrate different approaches to managing small domestic markets. Luxembourg uses its financial sector and the export of high-technology products to maintain its competitiveness despite its small population, while Malta focuses on tourism and niche production within the European Union. Iceland, with its modest population and its dependence on fishing and the export of renewable energy, demonstrates how small economies benefit from their natural resources. Additional examples include Cyprus, which promotes services and tourism, and Barbados, whose economy is strongly oriented toward services and tourism, reflecting typical small-economy strategies of specialization and export focus.[19, 20] These cases show how small size shapes trade patterns, policy choices, and economic resilience.

Other examples related to small African economies such as Mauritius and Rwanda are indicative of both the vulnerabilities and the opportunities of small-state trade strategies. Mauritius — often cited as a typical model of a successful small economy — uses trade openness, export processing zones, and preferential access to Europe and the United States to transform itself from a sugar-based economy into a diversified exporter of textiles, tourism, and financial services. Rwanda, although small, landlocked, and resource-poor, illustrates how this type of economy uses strategic state policy and regional integration to develop ICT services and high-quality agricultural exports (coffee/tea).

While trade theory defines small economies in terms of their price-taking behavior, international organizations often use specific criteria such as population, GDP, geographic size, or economic instability:

• *The World Trade Organization (WTO)* classifies small and vulnerable economies based on their economic size and export diversification. A small economy according to the WTO usually means a

[19] **IMF.** Small States: Overlapping Crises, Multiple Challenges. In: *Global Economic Prospects 2023*. International Monetary Fund, 2023. Available at: https://openknowledge.worldbank.org/entities/publication/59695a57-f323-5fa8-8c6f-d58bfa8918cd

[20] **World Bank.** *World Development Indicators*. Washington, DC: World Bank, 2024. Available at: https://datatopics.worldbank.org/world-development-indicators/

country with limited economic size and capacity to influence world markets, often defined as a “small vulnerable economy” (SVE), typically with a population below 1.5 million.[21]

• *The International Monetary Fund (IMF)* uses thresholds related to population and GDP, identifying countries with limited diversification and dependence on external trade and aid. The IMF defines “small states” as those with a population of up to 1.5 million, while also taking into account economic vulnerability and openness.[22]

• *The World Bank* focuses on the inherent vulnerabilities of small states, including geographic isolation, limited resources, and susceptibility to external shocks. The World Bank often defines “small states” as those with a population of up to 1.5 million, also considering factors such as remoteness, vulnerability, and limited diversification.[23]

These classifications often overlap with theoretical definitions, but discrepancies also exist. Some countries have small populations but exert significant influence in niche markets (for example, Singapore in high-technology exports). Conversely, larger countries may still be price takers in certain commodity markets.[24]

Awareness of the constraints of small economies influences trade and economic policy. The main implications include:

1. Trade liberalization as a source of welfare – reducing tariffs and non-tariff barriers improves consumer welfare and efficiency.[25, 26]

2. Diversification to reduce vulnerability – dependence on a narrow range of exports or markets exposes small economies to shocks. Diversification strategies, including industrial policy and regional trade agreements, reduce risks.[27, 28]

3. Integration into global value chains – specialization and participation in international production networks allow small economies to benefit from comparative advantages while gaining access to larger markets.[29]

4. External support and cooperation – multilateral support, development assistance, and international partnerships help small economies cope with global price instability.[30, 31]

In international trade theory, the small economy is defined not by its absolute size, but by its inability to influence world prices, which makes it a price taker in global markets. This theoretical definition has significant implications for trade policy, welfare analysis, and economic strategy. Although international organizations classify small economies by population size, GDP, or vulnerability indicators, the core principle remains that these economies are exposed to external shocks and have limited capacity for strategic trade interventions. As a result, policy strategies often focus on trade liberalization, diversification, regional integration, and external cooperation in order to maximize welfare and resilience.[32, 33, 34]

Based on the literature, *a working definition of a small economy can be derived as one whose domestic market is structurally limited in scale not only in terms of productive capacity but also in terms of consumer demand, such that international trade is not a matter of choice but of necessity*. Small size

[21] **WTO.** Op. cit.

[22] **IMF (**2013). Op. cit.

[23] **World Bank.** *Small States: A Roadmap for World Bank Engagement*. Washington, DC: World Bank, 2017. Available at: https://documents1.worldbank.org/curated/en/736071496248865262/pdf/FINAL-Small-States-Roadmap-05262017.pdf

[24] **Guerrón-Quintana, P.** Op. cit.

[25] **Bhagwati, J.** Op. cit.

[26] **Krugman, P. Obstfeld, M., Melitz, M.**, Op. cit.

[27] **Melitz, M.** Op. cit.

[28] **Restrepo-Echavarría, P.** Op. cit.

[29] **Appleyard, D., A. Field.** Op. cit.

[30] **IMF (**2023). Op. cit.

[31] **WTO**. Op. cit.

[32] **Krugman, P., M. Obstfeld, M. Melitz.** Op. cit.

[33] **Appleyard, D., A. Field.** Op. cit.

[34] **Bhagwati, J.** Op. cit.

here is not defined by a single quantitative threshold, but by a combination of factors: relatively modest GDP, population size, and market scope, combined with a high degree of dependence on external markets both for raw materials and for markets of realization. In this sense, "small" does not mean weakness, but rather denotes an economy whose growth and stability are conditioned by the external environment to a much greater extent than in large economies.

2. Openness as a Structural Characteristic of an Economy

According to theory, the term open economy refers to one that engages in the import and export of goods and services and participates in cross-border financial flows. Its characteristic feature is openness to international markets, which allows domestic agents to have access to foreign goods, technologies, and capital, and foreign agents to invest in or purchase domestic output.[35, 36]

Formally, the open economy differs from the closed economy in that decisions on domestic consumption and production are influenced by world prices. While in a closed economy demand and supply determine domestic prices, the open economy is dependent on world prices of tradable goods, which makes trade an important factor for domestic welfare. In classical theory, the models of Ricardo and Heckscher–Ohlin demonstrate how open economies gain from specialization based respectively on comparative advantages and factors of production.[37, 38, 39]

International institutions do not provide a formal definition of an "open economy", but the term is used to describe economies with low barriers to trade and capital and with active integration into the global economy. Widely used as a summary indicator of an economy's "openness" to the world is the trade-to-GDP ratio. It is defined as the sum of exports and imports of goods and services divided by the country's GDP. This indicator shows the degree of dependence of domestic producers on external demand, as well as of domestic consumers and producers on external supply. In the literature, variants are also encountered in which only exports or only imports relative to GDP are included, but the most common definition is (Exports + Imports)/GDP, expressed as a percentage. This indicator is used by institutions such as the World Bank and the OECD, as well as by numerous authors in the economic literature. It is important to note that the trade-to-GDP ratio may be influenced by factors such as country size, geographic remoteness, prices of exported and imported goods, the exchange rate, and investment, which must be taken into account when interpreting results.[40, 41]

Open economies have several distinctive features that differentiate them from closed economies:

1. Participation in international trade. Open economies engage in exports and imports of goods and services, often across multiple sectors, which influences choices of production and consumption.[42]

2. Exposure to world prices. Prices of tradable goods are determined in global markets. Domestic producers and consumers are price takers for goods traded on the international market.[43]

3. Capital mobility. Open economies can borrow or lend internationally, invest in foreign assets, or attract foreign investment, which affects domestic interest rates and capital accumulation.[44, 45]

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[35] **Krugman, P., M. Obstfeld, M. Melitz.** Op. cit.

[36] **Appleyard, D., A. Field.** Op. cit.

[37] **Ricardo, D.** Op. cit.

[38] **Samuelson, P.** Op. cit.

[39] **Heckscher, E. Ohlin, B.** Op. cit.

[40] **Bleaney, M., M. Tian.** The Trade-GDP Ratio as a Measure of Openness. *The World Economy, Wiley Blackwell*, Vol. 46 (5), 2022, pp. 1319–1332. https://doi.org/10.1111/twec.13355

[41] **Idris, J., Z. Yusop., M. Habibullah.** Trade Openness and Economic Growth: A Causality Test in Panel Perspective. *International Journal of Business and Society*, 17 (2), 2017. https://doi.org/10.33736/ijbs.525.2016

[42] **Krugman, P., M. Obstfeld, M. Melitz.** Op. cit.

[43] **Samuelson, P., W. Nordhaus.** Op. cit.

[44] **Bhagwati, J.** Op. cit.

[45] **IMF (**2023). Op. cit.

4. Openness index. As noted, economists often measure the degree of openness using the ratio of trade to GDP or the sum of exports and imports relative to national output.[46, 47]

5. Vulnerability to external shocks. Dependence on global markets exposes open economies to fluctuations in foreign demand, volatility in commodity prices, exchange rate changes, and reversals of capital flows.[48, 49]

The main difference between open and closed economies lies in their interaction with global markets (see Table 2). A closed economy produces everything it consumes and cannot participate in international borrowing or lending, while an open economy uses global markets to optimize decisions on consumption, production, and investment.[50]

Table 2. Differences Between Open and Closed Economies

Characteristic	Open economy	Closed economy
Participation in trade	Engages in imports and exports; interacts with global markets	No international trade; self-sufficient
Price determination	Domestic prices of tradable goods are influenced by world prices	Domestic prices are determined solely by internal supply and demand
Capital mobility	Can borrow, lend, and invest internationally; foreign investment is possible	No access to foreign capital; domestic savings determine investment
Gains from trade	Gains from specialization and comparative advantage	No gains from trade; relies solely on domestic production
Exposure to external shocks	Vulnerable to global demand, commodity prices, and financial market fluctuations	Isolated from global disturbances; vulnerable only to internal factors
Policy implications	Trade, monetary, and fiscal policy must account for global interconnections	Policy can focus solely on domestic objectives
Market size	Effectively expanded through access to foreign markets	Limited to domestic population and productive capacity
Diversification	Can diversify exports and imports to reduce risk	Limited to domestic production possibilities

Source: Compiled by the author based on Krugman, Obstfeld & Melitz (2022); Appleyard & Field (2017); Samuelson & Nordhaus (2009).

Open economies can achieve gains from trade through specialization and comparative advantages. For example, a country endowed with an abundance of skilled labor may export technologically intensive products and import labor-intensive goods, thereby achieving higher overall welfare than under autarky.[51, 52] Similarly, capital flows allow investments that exceed domestic savings, which increases productive capacity and economic growth.[53, 54]

Open economies are characterized by high integration into global markets and sensitivity to external economic conditions. Examples of small but open economies include Singapore, Estonia, and Costa Rica, which maintain high trade-to-GDP ratios. Singapore combines minimal tariffs with strong export promotion and strategic sectoral policies, especially in high-technology manufacturing and services, reflecting the advantages of openness. Estonia has developed a competitive information technology sector

[46] **Appleyard, D., A. Field.** Op. cit.
[47] **World Bank** (2024). Op. cit.
[48] **Guerrón-Quintana, P.** Op. cit.
[49] **Melitz, M.** Op. cit.
[50] **Krugman, P., M. Obstfeld, M. Melitz.** Op. cit.
[51] **Ricardo, D.** Op. cit.
[52] **Heckscher, E., Вл. Ohlin.** Op. cit.
[53] **IMF (**2023). Op. cit.
[54] **Bhagwati, J.** Op. cit.

and participates fully in the EU single market, illustrating how openness facilitates global integration and the development of the digital economy. Costa Rica, although smaller, is export-oriented, with openness manifested primarily in agricultural exports and integration into CAFTA-DR, demonstrating the benefits of trade agreements and diversification. Qatar and Bahrain are examples from the Middle East that show how liberal trade regimes, infrastructure investment, and participation in regional agreements such as the Gulf Cooperation Council (GCC) Customs Union enable highly open economies to prosper despite limited domestic markets.[55, 56]

These examples show that openness increases economic opportunities, but it must be emphasized that at the same time it exposes countries to global instability. Illustrative in this respect are African countries such as Botswana and Kenya, which show how openness can be both a source of vulnerability and a lever for specialization in global markets. Botswana is an African example of an open economy that relies heavily on diamond exports, but successfully manages openness through institutions and trade policy, avoiding the "resource curse", while Kenya is medium-sized but highly open in services and horticulture – a case in which trade openness has contributed to integration into global value chains, especially with Europe.

As discussed above, open economies face not only opportunities but also considerable challenges. Therefore, understanding and taking into account their characteristics is essential for the effective design of policies:

1. Trade policy. Open economies can benefit from reducing tariffs and trade barriers in order to maximize gains from comparative advantage.[57, 58] Nevertheless, strategic sectors may need protection if domestic stability is threatened by external shocks.[59]

2. Exchange rate policy. To maintain competitiveness, open economies must manage exchange rates, control inflation, and stabilize the balance of payments.[60]

3. Management of capital flows. Financial openness allows efficient investment but also creates risks of capital flight, sudden stops, or financial crises. Policies must balance openness with stability.[61], [62]

4. Diversification and resilience. Open economies must diversify exports and sources of imports in order to reduce vulnerability to global disturbances.[63, 64]

5. Participation in global value chains. Integration into regional and global value chains allows open economies to use their comparative advantages, gain access to technologies, and increase productivity.[65]

In international trade theory, the open economy is defined by its participation in trade and financial transactions with the rest of the world. This participation subjects domestic markets to the influence of world prices and capital flows, which allows gains from specialization and comparative advantages to be realized, but also increases vulnerability to global disturbances. Understanding open economies is of decisive importance for the formulation of trade, monetary, and fiscal policies that maximize welfare while maintaining economic resilience.[66, 67, 68] In practice, policymakers in such economies must balance the

[55] **WTO.** Op. cit.

[56] **Melitz, M.** Op. cit.

[57] **Krugman, P., M. Obstfeld, M. Melitz.** Op. cit.

[58] **Appleyard, D., A. Field.** Op. cit.

[59] **Melitz, M.** Op. cit.

[60] **Gali, J., T. Monacelli.** Monetary Policy and Exchange Rate Volatility in a Small Open Economy. *Review of Economic Studies*, 72 (3), 2005, pp. 707–734. https://doi.org/10.1111/j.1467-937X.2005.00349.x

[61] **IMF** (2023). Op. cit.

[62] **Restrepo-Echavarría, P**, Op. cit.

[63] **World Bank.** *Global Economic Prospects.* Washington, DC: World Bank, 2022. Available at: https://openknowledge.worldbank.org/entities/publication/785d9bcf-89e5-5a42-925b-a996f2861208

[64] **Guerrón-Quintana, P.** Op. cit.

[65] **Appleyard, D., A. Field.** op. cit.

[66] **Krugman, P., M. Obstfeld, M. Melitz.** Op. cit.

[67] **Appleyard, D., A. Field.** Op. cit.

[68] **Samuelson, P., W. Nordhaus.** Op. cit.

benefits of international integration with the risks associated with exposure to global markets, ensuring both competitiveness and stability.

For the purposes of this study, the open economy is defined not only by the trade-to-GDP ratio, but also by the structural characteristics of its external orientation. *An open economy is one that maintains low barriers to international transactions, relies to a significant extent on imports and exports for its production and consumption needs, and is deeply integrated into global and regional value chains.* Openness refers not only to statistical indicators of trade intensity, but also to the institutional, regulatory, and infrastructural mechanisms that facilitate cross-border exchange. Of decisive importance is that openness leads to increased exposure to external shocks — economic, political, or technological — which must be compensated for through adaptive strategies.

3. Trade Policy in Small and Open Economies: Strategies and Limitations

Trade policy is a core instrument for small and open economies, which rely to a large extent on international markets for economic growth and domestic welfare. As already noted, unlike large economies, small and open economies are price takers – they cannot influence world prices through tariffs, subsidies, or other policy interventions.[69, 70] Consequently, their trade policies must prioritize the improvement of domestic welfare, competitiveness, and resilience to external shocks, rather than the manipulation of world market conditions. Classical trade theory, including Ricardo's model and the conceptual framework of Heckscher–Ohlin, emphasizes the importance of specialization according to comparative advantages — a principle that underlies policy approaches for these economies.[71, 72, 73] Contemporary trade policy places additional emphasis on liberalization, export promotion, integration into regional and global markets, trade facilitation, and strategic sectoral support.[74, 75, 76]

Small and open economies use a combination of trade policy instruments designed to maximize gains from international markets while managing their inherent weaknesses:

• *Trade liberalization.* Reducing tariffs and non-tariff barriers is of fundamental importance. Since these economies are price takers, liberalization improves efficiency and consumer welfare by providing access to a wider variety of goods and services at competitive prices.[77]

• *Export promotion.* Governments often support sectors with export potential through subsidies, tax incentives, investments in logistics and infrastructure, as well as programs to improve skills and innovation.[78, 79] Export promotion allows small markets to overcome limitations related to the size of the domestic market by increasing their international competitiveness.

• *Regional and multilateral integration.* Participation in regional trade agreements and multilateral frameworks expands market access, stabilizes trade flows, and provides collective bargaining power.[80] Integration also reduces transaction costs, harmonizes standards, and facilitates the participation of domestic firms in global value chains.[81]

• *Trade facilitation and infrastructure development.* Efficient customs procedures, logistics systems, transport infrastructure, and digital trade platforms are of decisive importance. High transaction

[69] **Krugman, P., M. Obstfeld, M. Melitz.** Op. cit.

[70] **Appleyard, D., Ал Field.** Op. cit.

[71] **Ricardo, D.** Op. cit.

[72] **Heckscher, E., B. Ohlin.** Op. cit.

[73] **Samuelson, P.** Op. cit.

[74] **Melitz, M.** Op. cit.

[75] **IMF (**2023). Op. cit.

[76] **World Bank** (2024). Op. cit.

[77] **Krugman, P., M. Obstfeld, M. Melitz.** Op. cit.

[78] **Melitz, M.** Op. cit.

[79] **Appleyard, D., A. Field.** Op. cit.

[80] **Spasova, E.** Strategic Regionalism: Deep Trade Agreements and the Governance of Global Value Chains in a Fragmented World Economy In: Marinov, E. (ed.). *International Scientific Conference "The Economy of the 21st Century: Economic Innovations and Sustainable Growth". Proceedings.* Sofia: New Bulgarian University, 2025, pp. 319–327. https://doi.org/10.5281/zenodo.17387506

[81] **WTO.** Op. cit.

costs can negatively affect the competitiveness of small and open economies, which makes the removal of trade barriers a key policy priority.[82]

• *Strategic and sectoral policies.* While broad protectionist measures have limited effects on world prices, targeted interventions in high value-added sectors such as innovation, research and development, or specialized industries can enhance competitiveness and allow economies to participate effectively in global markets.[83, 84]

• *Diversification policies.* Small and open economies are vulnerable to external shocks if trade is concentrated in a few products or markets. Trade policy often encourages diversification — expanding export portfolios across multiple sectors, reducing dependence on a single trading partner or region, and promoting intra-industry trade and regional value chains. Diversification strengthens resilience to global recessions, commodity price fluctuations, and geopolitical tensions.[85, 86]

An additional dimension of trade policy in small and open economies is the role of policy innovation, which extends beyond conventional instruments of liberalization and export promotion. Some economies are pioneers in developing distinctive strategies to secure niches in the global economy, compensating for their limited size and vulnerability. Rwanda's Vision 2050 illustrates how a landlocked African economy seeks to position itself as a regional hub for digital services, fintech, and ICT-based exports.[87, 88] Similarly, Uruguay has transitioned toward renewable energy, achieving one of the highest shares of wind and solar energy in electricity generation worldwide, which not only reduces dependence on imports but also creates a platform for exporting expertise in renewable energy and green services.[89] In the Caribbean, Jamaica experiments with exports of cultural industries and music services, positioning itself internationally as a creative hub.[90] Such examples highlight how innovative, locally adapted policies allow small and open economies to create non-traditional comparative advantages that enhance resilience and global competitiveness.

Small and open economies apply different strategies for trade liberalization, export promotion, and sectoral diversification (see Table 3). While developed economies such as Luxembourg or Singapore benefit from financial services and logistics, emerging economies such as Mauritius and Rwanda show how trade policy, regional integration, and sectoral strategies can support structural transformation. The countries included in Table 3 are illustrative rather than exhaustive and are selected to reflect different regional contexts and development levels among small and open economies.

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[82] **Schiff, M.** Op. cit.

[83] **Melitz, M.** Op. cit.

[84] **Appleyard, D., A. Field, A.** Op. cit.

[85] **Guerrón-Quintana, P.** Op. cit.

[86] **Melitz, M.** Op. cit.

[87] **World Bank.** *Rwanda Digital Economy Diagnostic*. Washington, DC: World Bank, 2019. Available at: https://thedocs.worldbank.org/en/doc/08165a76ca0f1ef688d2782dfaab3406-0400072022/related/Rwanda-DE4A-Summary-Report-final-for-feedback.pdf

[88] **IMF (**2023). Op. cit.

[89] **Foster, V., A. Rana.** *Rethinking Power Sector Reform in the Developing World.* Washington, DC: World Bank, 2020. https://doi.org/10.1016/j.jedc.2013.03.006

[90] **UNCTAD.** *Building resilience in small island developing states.* UNCTAD/ALDC/INF/2021/3. Geneva: UNCTAD, 2022. Available at: https://unctad.org/publication/building-resilience-small-island-developing-states

Table 3. Trade Policy Strategies and Structural Adaptations in Small and Open Economies

Country	Trade liberalization	Export promotion	Regional / multilateral integration	Trade facilitation and infrastructure	Strategic / sectoral policies
Luxembourg	Low tariffs through EU membership	Financial services, high-technology manufacturing	EU single market	Efficient logistics and digital services	Fintech, research and development in technology
Singapore	Minimal tariffs, open market	Electronics, chemicals, services	CPTPP, ASEAN, bilateral free trade agreements	World-class ports and airports	High-technology innovation, finance
Malta	EU-aligned tariffs	Tourism, niche manufacturing	EU single market	Modernization of customs, ports	Tourism infrastructure, SMEs
Cyprus	Low tariffs, EU member	Tourism, services	EU single market	Modernization of ports and airports	Tourism and services
Iceland	WTO-aligned tariffs	Fisheries, renewable energy	EFTA, European Economic Area	Efficient maritime infrastructure	Fisheries
Bahrain	Low tariffs, open trade zones	Oil refining, financial services	GCC Customs Union	Logistics hubs, free trade zones	Financial and energy sector
Qatar	Minimal tariffs	Liquefied natural gas, financial services	GCC Customs Union	Investment in ports and transport	Energy sector and research and development
New Zealand	Open trade agreements	Dairy products, meat, wine	CPTPP, RCEP	Efficient ports, logistics	Innovation in agriculture
Costa Rica	Reduced tariffs	Coffee, electronics	CAFTA-DR	Modernization of customs	Ecotourism and technology clusters
Estonia	EU-aligned tariffs	IT services, manufacturing	EU single market	Digital infrastructure	E-government and IT sector
Barbados	Open trade, WTO-compliant	Tourism, services	CARICOM	Port modernization	Tourism development programs
Hong Kong	Free port policy, low tariffs	Finance, logistics	CEPA	World-class ports and airports	Financial and logistics sector
Mauritius	Gradual removal of trade barriers while retaining selective protective measures	Strong export processing zones; promotion of textiles, tourism, and financial services	Active WTO member; signatory to multiple preferential agreements (EU, U.S. AGOA, COMESA, AfCFTA)	Investment in port infrastructure, logistics services, and ICT infrastructure to support diversification	Policy of diversification beyond sugar toward textiles, tourism, ICT, and financial services
Rwanda	Commitment to WTO and AfCFTA frameworks	Targeted promotion of coffee, tea, and ICT-based services exports	Deep engagement in EAC and AfCFTA; active use of regional integration for market access	Investment in transport corridors, customs modernization, and digital trade platforms	Strategic push to position as an ICT hub and “Made in Rwanda” industrial policy
Bulgaria	EU-aligned tariffs, open market	Machinery, ICT, agriculture	EU single market, EU trade agreements	Modernization of ports and transport, digital customs	Support for export-oriented sectors, ICT clusters

Source: Compiled by the author based on data and analyses of the IMF, WTO, World Bank, and UNCTAD.

The examples in Table 3 show that all economies of this type share a common trend – trade policies focus on liberalization, facilitation, strategic sectoral support, and integration into regional or global frameworks, rather than attempts to influence world prices. Small and open economies use similar trade policy instruments, adapted to their specific conditions and regional affiliations. Across countries, similar patterns are observed — trade liberalization is widely applied to improve access to world markets, while export promotion strategies are sector-specific and reflect the factors of production and comparative advantages of each economy. Regional and multilateral integration provides critical market access and regulatory harmonization, especially for small economies in Europe, Asia, and Africa. Trade facilitation and infrastructure improvement are encountered almost everywhere, indicating that reducing transaction costs is of primary importance for maintaining competitiveness. Strategic interventions such as support for research and development, ICT development, or strengthening of the financial sector show that even small and open economies can find niches in global value chains to strengthen their positions. Bulgaria, for example, follows this model through EU-aligned liberalization, export promotion in machinery, ICT, and agriculture, and strategic policies aimed at ICT clusters.

The comparative analysis also highlights the existing diversity in national strategies — while some countries rely heavily on the financial sector or services (Luxembourg, Singapore), others emphasize agriculture, tourism, or energy (Costa Rica, Bahrain). This confirms that although the core instruments are similar for small and open economies, their application is determined primarily by domestic factors, historical specialization, and regional integration agreements.

Small and open economies face unique challenges in the implementation of trade policy. Their position as price takers reduces the effectiveness of policy in terms of influencing world prices, narrowing the scope for improving terms of trade through traditional instruments such as tariffs or quotas.[91] The vulnerability of these economies is reinforced by their dependence on a limited number of trading partners and exports, exposing them to external shocks, including global recessions, commodity price fluctuations, and geopolitical risks.[92, 93] In addition, the small domestic market requires trade policy to be coordinated with macroeconomic policies, such as exchange rate management, monetary policy, and fiscal measures, in order to maintain competitiveness and avoid macroeconomic imbalances.[94]

Taking into account the challenges outlined above, and based on theoretical and empirical observations, several important recommendations related to trade policy in small and open economies can be clearly identified. Trade liberalization should remain a central pillar, ensuring access to a wide range of goods, services, and raw materials while reducing domestic inefficiencies. Export promotion should focus on sectors with the greatest potential for competitiveness, particularly high-value-added industries capable of integrating into global value chains.[95] Participation in regional and multilateral trade agreements should be supported, as it leads to improved market access, regulatory harmonization, and increased bargaining power, compensating for limitations associated with small size.[96] Investments in trade facilitation and infrastructure – ports, digital customs platforms, and logistics networks – should be encouraged, as they reduce transaction costs, increase efficiency, and accelerate global integration. Finally, strengthening strategic and sectoral interventions aimed at innovation, research and development, or niche industries would allow small and open economies to build competitive advantages despite limited domestic markets.[97]

Overall, these measures support a policy framework that balances openness with resilience, diversification, and targeted support. Countries such as Singapore, Luxembourg, and Malta exemplify how consistent trade policy can leverage small size and openness to achieve growth and integration into the global economy. Although many of these policy instruments are well established in the literature, their

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[91] **Krugman, P., M. Obstfeld, M. Melitz.** Op. cit.

[92] **Guerrón-Quintana, P.** Op. cit.

[93] **Restrepo-Echavarría, P.** Op. cit.

[94] **Gali, J., T. Monacelli.** Op. cit.

[95] **Melitz, M.** Op. cit.

[96] **WTO**. Op. cit.

[97] **Appleyard, D., A. Field.** Op. cit.

relevance for small and open economies derives from the specific structural constraints associated with limited market power and high external dependence.

As emphasized, trade policy in small and open economies is primarily shaped by their position as price takers, their strong dependence on international markets, and their vulnerability to external shocks. Classical trade theory stresses the benefits of specialization and comparative advantages,[98], [99] while contemporary policy focuses on liberalization, export promotion, integration, trade facilitation, and strategic sectoral support.[100], [101] The comparative analysis of numerous small and open economies, including Bulgaria, Luxembourg, Singapore, and Malta, shows that consistent instruments are applied in different contexts, with adjustments reflecting domestic factors and regional integration. Both traditional instruments and policy innovations, such as Rwanda's digital strategy or Uruguay's green transition, demonstrate that small economies increasingly diversify the ways in which they integrate into world trade. Although many challenges remain unresolved, particularly those related to external shocks and limited policy influence, the combination of liberalization, export promotion, facilitation, and strategic interventions enables such economies to maximize welfare, competitiveness, and resilience in international trade.

4. Can Bulgaria be Defined as a Small and Open Economy?

Synthesizing the views presented, the small and open economy can be defined as one that combines the structural constraints of small scale with the trade dependence and vulnerability associated with openness. Such economies cannot rely on domestic demand or on the resources at their disposal to sustain growth; instead, they must continuously take advantage of integration into regional and global markets in order to generate competitiveness, attract investment, and maintain innovation. Their resilience depends on diversification of trading partners, sectors, and policy instruments, as well as on the proactive use of multilateral and regional trade frameworks. It is precisely through this conceptual lens that Bulgaria's position in international trade in the twenty-first century will be analyzed.

Bulgaria can be classified as a small and open economy on the basis of both theoretical criteria and empirical indicators. The economic transformations after 1989 laid the foundations of the country's current foreign trade structure.[102] As a small economy, Bulgaria has limited influence on world prices due to its relatively modest GDP and population size compared to global markets, which prevents it from influencing international prices of most of the goods it trades.[103], [104] The domestic market is relatively small, which means that growth cannot be sustained solely by domestic production. Consequently, exports play a decisive role in supporting economic development, especially through trade with partners from the European Union.[105] The structure of Bulgarian exports reflects its comparative advantage — the core of its foreign trade portfolio consists of factors of production such as machinery, automotive parts, agricultural products, and ICT services. [106, 107]

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[98] **Ricardo, D.** Op. cit.

[99] **Heckscher, E., B. Ohlin.** Op.cit.

[100] **Melitz, M.** Op. cit.

[101] **IMF (**2023). Op. cit.

[102] **Spasova, E., Tzvetanova-Georgieva, E.** Bulgaria after 1989: The path to economic development and well-being of its population. In: Marinov, E. (ed.). *International Scientific Conference "The Economy of the 21st Century: Economic Innovations and Sustainable Growth". Proceedings.* Sofia: New Bulgarian University, 2025, pp.104–114. https://doi.org/10.5281/zenodo.17387506

[103] **Krugman, P., M. Obstfeld, M. Melitz.** Op.cit.

[104] **Samuelson, P., W. Nordhaus,** Op.cit.

[105] **Nestorov, N.** Features of the Export Activity of Bulgarian Companies. In: *Economic Development and Policies: Realities and Prospects. European Integration, Convergence and Cohesion.* Sofia: ERI at BAS, 2025, pp. 398–402. Available at: https://www.iki.bas.bg/files/sbornik_2025.pdf

[106] **Heckscher, E., B. Ohlin.** Op.cit.

[107] **Ricardo, D.** Op. cit.

From the perspective of the open economy, Bulgaria demonstrates a high degree of integration into global markets, as evidenced by the significant trade-to-GDP ratio.[108] Participation in regional and global agreements further reinforces openness — as a member of the European Union, Bulgaria is fully integrated into the single market and benefits from the EU's trade agreements with third countries, while accession to the Schengen Area is seen as an opportunity to expand exports of specific products.[109] This exposure not only provides opportunities but also generates risks due to sensitivity to fluctuations in global demand, changes in commodity prices, and economic cycles throughout the EU.[110], [111] Bulgaria's openness is also reflected in the attraction of foreign direct investment and participation in cross-border financial flows,[112] which indicates active engagement in international capital markets.

The implications for Bulgaria's trade policy arise naturally from these characteristics. The country emphasizes liberalization and integration into the EU rather than attempting to manipulate world prices, while export promotion is a key priority, particularly in the sectors of machinery, agriculture, and ICT.[113] Bulgaria actively participates in regional and multilateral trade agreements to secure market access and deepen integration. Additional policies are also implemented to improve competitiveness and reduce trade transaction costs through investments in infrastructure and digitalization. At the same time, policy-makers are aware of the country's vulnerability to external shocks, which motivates efforts to diversify both export markets and product portfolios.

Overall, Bulgaria fits the profile of a small and open economy. The limited domestic market, dependence on exports, integration into regional and global trade frameworks, and exposure to external shocks confirm this classification. Given this, it is very important that Bulgarian trade policy continue to prioritize liberalization, export promotion, diversification, and strategic sectoral support within the context of the EU and, more broadly, the global economy.

Bulgaria's trade policy reflects precisely these structural constraints and opportunities. As part of the European Union, the country does not possess an independent tariff policy toward third countries, but participates in the Union's common trade policy, which provides access to global markets through a network of trade agreements. This represents a typical example of the use of regional integration as a compensatory mechanism for small economies, which through collective action overcome the limitations of their individual scale.

At the same time, the conceptual framework shows that the long-term sustainability of the Bulgarian economy depends on its capacity for diversification — both in terms of trading partners and in terms of the product and sectoral structure of exports. In this sense, the Bulgarian case confirms the core conclusion of the theory of small and open economies: that successful participation in international trade is not based on market power, but on adaptability, institutional quality, and the strategic use of integration frameworks.

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[108] **Zhelev, P.** *Bulgaria in the Global Economy – Dynamics, Challenges and Opportunities.* Cham: Springer Nature, 2025. https://doi.org/10.1007/978-3-031-87923-4

[109] **Branzova, P., A. Dimitrova, A. Pavlov.** Bulgaria's Entry into the Schengen Area: Opportunities for Expanding Exports of Fresh Fruits, Vegetables, Wines, Essential Oils and Organic Products. In: Marinov, E. (ed.). *International Scientific Conference "The Economy of the 21st Century: Economic Innovations and Sustainable Growth". Proceedings.* Sofia: New Bulgarian University, 2025, pp. 409–413. https://doi.org/10.5281/zenodo.17387506

[110] **IMF (**2023). Op. cit.

[111] **World Bank (**2022). Op. cit.

[112] **Kolikova, G.** Bulgaria's Investment Competitiveness in the Global Value Chains. In: Marinov, E. (ed.). *International Scientific Conference "The Economy of the 21st Century: Economic Innovations and Sustainable Growth". Proceedings.* Sofia: New Bulgarian University, 2025, p. 406–408. https://doi.org/10.5281/zenodo.17387506

[113] **Rădulescu, A., Oehler-Șincai, I. M.** EU Economic Integration – The Macroeconomic Performance of Bulgaria and Romania after 2007. In: Marinov, E. (ed.). *International Scientific Conference "The Economy of the 21st Century: Economic Innovations and Sustainable Growth". Proceedings.* Sofia: New Bulgarian University, 2025, pp. 393–399. https://doi.org/10.5281/zenodo.17387506

Conclusion

While smallness and openness often coexist in practice, trade theory treats them as analytically distinct characteristics, with smallness referring to the absence of market power and openness to the degree of integration into international trade and financial flows.

The analysis of small and open economies within the framework of international trade theory shows that their economic opportunities and constraints derive not so much from their absolute size as from the lack of market power and their high degree of dependence on international markets. As price takers, these economies cannot use trade policy to influence world prices, which predetermines a specific focus on liberalization, diversification, and integration as the main instruments for enhancing welfare and resilience.

Openness provides significant benefits in the form of specialization, economies of scale, and access to technologies and capital, but at the same time increases vulnerability to external economic and geopolitical shocks. For this reason, successful policies in small and open economies require a balanced approach that combines openness with active measures aimed at diversification and institutional strengthening.

The main conclusion is that small and open economies operate under conditions of structural dependence on the international environment, which cannot be eliminated through trade policy but can only be managed. Trade liberalization, export diversification, integration into global value chains, and participation in regional integration groupings emerge as key strategies for adaptation , as implied by the structural constraints identified in international trade theory. In this context, trade policy ceases to be an instrument for influencing world markets and instead becomes a mechanism for enhancing internal competitiveness and resilience.

From a broader perspective, the analysis confirms that small and open economies are not doomed to a peripheral role in world trade. On the contrary, through targeted specialization, institutional development, and strategic use of integration frameworks, they can secure a sustainable place in the transforming architecture of international trade.

The case of Bulgaria confirms these theoretical conclusions. The limited domestic market, the high degree of trade openness, and deep integration into the European Union clearly characterize the country as a small and open economy. At the same time, EU membership functions as a compensatory mechanism that expands the effective market and provides access to a stable institutional framework. In the long term, Bulgaria’s sustainable participation in international trade depends on its ability to diversify exports, enhance competitiveness, and strategically use the opportunities arising from regional and global integration.

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