

Official Paper

# Trade Problems of Developing Economies

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**World Economic Survey, 1963:**Part I: Trade and Development: Trends, Needs and Policies, United Nations, New York, 1964.

*The most important prerequisite for progress in any theorising about the international economics of development today — the problems of foreign trade and capital flows associated with the economic growth of the developing countries — is a clear awareness of the problems faced by the developing economies and a careful sorting out of the basic issues involved.*

*It is in this area that a sound empirical work can make an immensely significant contribution.*

*Even if it only describes facts and relevant issues and organises the information in terms of consistent categories without providing satisfactory theoretical explanations for them, it would stimulate analytical discussions from which good theories might emerge.*

*A lot of materials, well organised and carefully sifted, has been furnished by the World Economic Surveys, published from the U N Secretariat, which have maintained a consistently high standard of analysis.*

*The latest volume of World Economic Survey, 1963, Part I is a significant addition to the literature in this field and has all the potentialities of becoming a classic for the factual materials it so competently presents, and the issues and problems it so clearly focusses, if not also for its provocative policy prescriptions.*

THE increasing interest in the problems of economic growth of the underdeveloped countries is a remarkable phenomenon in the process of economic thinking in the post-war period.

Recently, theorising in different branches of this field has become quite sophisticated. Advanced tools of modern economic analysis have been brought to bear on the problems of economic planning and other aspects of growth of the developing countries.

But progress has been rather limited in what may be called the international economics of development that branch of the subject which deals with the problems of foreign trade and capital flows associated with the economic growth of the developing countries. Propositions that are discussed here are mostly marginal variations of those of the neo-classical trade theory with comparative-statics extensions of the full-employment, equilibrium, static models. Few interesting ideas have been advanced and tested in this held in recent years that have direct relevance to specific problems of the developing economies, although in the early phase of the growing interest in the economics of development, several potent propositions emerged out of the works in connection with international economics like the famous essay of Rosenstein-Rodan, or the writings of Ragnar Nurkse...

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economics of development is a clear awareness of the problems faced by the developing economies and a careful sorting out of the basic issues involved. It is here that a sound empirical work can make an immensely significant contribution.

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### Few Empirical Studies

There have been several first-rate empirical studies on the international economic problems of the developed countries, e g, the works of Iversen, Schloie, Cairncross, Svennilson, Kindleberger, etc, to mention only a few. But very few empirical studies on the international economics of the developing countries have been attempted and information about the practical problems faced by these countries are mostly scattered, unorganised and specific, to individual countries. The only major contributions in this held have been made by the international agencies like the United Nations and its organs.

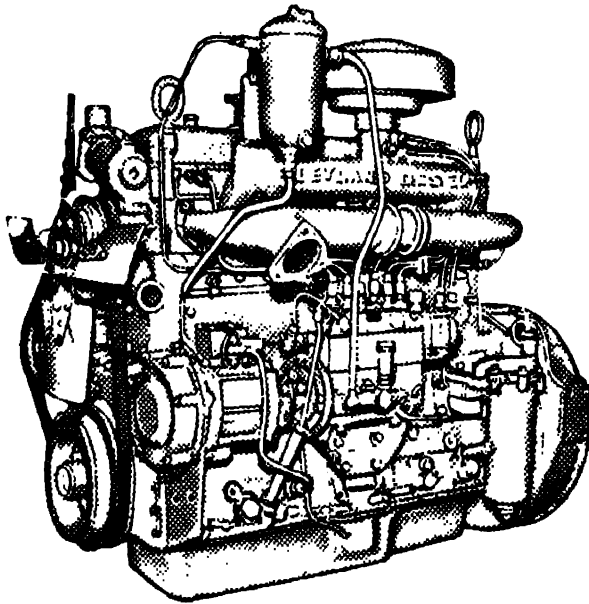
Different commissions and divisions of the United Nations have been trying through their reports and surveys to tackle several international trade problems and produce a consistent empiri-

cal picture of the developing countries. Hilgerdt's famous study on "Industrialisation and Foreign Trade" on behalf of League of Nations, 1945 is still the best of its kind. It also goes entirely to the credit of the Economic Commission for Latin America that their studies in terms of trade have been able to stimulate interest and provoke discussion on a very vital problem of the developing economies, although their statistical exercise and theoretical explanations may not have been quite satisfactory.

A lot of material, well organised and carefully described, has been furnished by the World Economic Surveys, published from the U N Secretariat, which have maintained a consistently high standard of analysis. The latest volume of World Economic Survey, 1963, Part I is a significant addition to the literature in this field and has all the potentialities of becoming a classic document for the factual materials it so competently describes, and the issues and problems it so clearly focusses, if not also for the policy prescriptions it so provocatively makes.

This volume brings together the papers prepared in the Bureau of General Economic Research and Policies for the use of the U N Conference on Trade and Development. Not unexpectedly, most of the papers are policy-oriented and attempts have been made, all through this big volume, to bring out clearly the basic policy issues involved. Naturally discussions on policy

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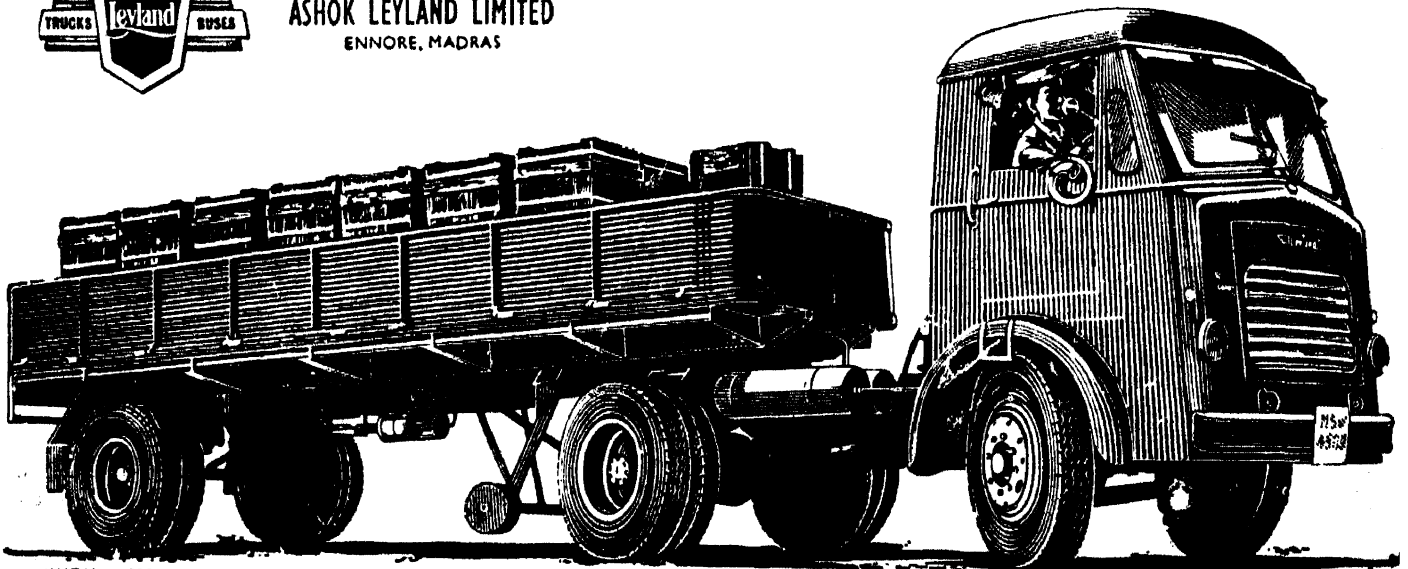
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on such a broad scale as for the developing countries as a whole are bound to be controversial and in several cases the points made in these papers are open to criticism. There is a general awareness that policies for reducing tariffs and other barriers to the expansion of exports from the developing countries or for stimulating capital flows to these countries and their effective use should be internationally co-ordinated. But exactly how this co-ordination is to be achieved is really the question which has not been tackled. Tariffs or non tariff restrictions are imposed for different purposes and the implications of their removal will depend on the severity of these barriers, the nature of the commodities, their importance in the consumption and production relations of the countries, the mobility of resources and the flexibility of the economic structures. Similarly capital flows from developed countries in different forms and varieties will have different impact on their economies depending on the structure of their balance of payments and the composition of trade. Gross disparities among the developed countries with regard to all these would make any international coordination of their policies extremely difficult, although such coordination is obviously necessary "to maximise the possibilities of trade expansion for the developing countries while minimising the costs for the industrial countries."

The detailed study of any such programme of international coordination was not within the scope of this volume. But there should have been some attempt to provide rough quantitative estimates of gains and losses associated with at least some policy measures for selected countries or groups of countries. True, no attempt in this direction at such broad level could be entirely satisfactory, but it is necessary for the advance of any policy-programme that there should be some awareness of possible gains and losses and nothing can be more helpful here than some attempt to deal quantitatively with the issues involved, however approximate they may be. This volume could surely incorporate some studies, if not only for purposes of illustration, on the effects of the removal of some percent of tariffs and other duties or non-tariff barriers from some specific commodities — (and only a few commodities are relevant for the developing countries) — by some developed countries, say, the United States, or the EEC or the EFTA or some combinations of them, on the exports of the

developing countries and on the balance of payments or the loss of revenues of the developed countries. Similarly, some rough estimates could be provided for the impact on the balance of payments of the developed countries of increasing capital flows in different forms to the developing countries, or untying of aid to specific projects or sources of procurement.

Of course these studies would have to be in rather broad terms and in most cases would rely on partial analysis as indirect and chain effects are often very difficult to quantify. Considering the accent on policy-suggestion throughout this volume, such studies would have been valuable supplements to the highly competent analysis of the problems in the different papers. It is for getting some quantitative feeling of the magnitudes involved that the readers will welcome the chapter on "Trade Needs of Developing Countries."

#### Trade Needs of Developing Countries

In this chapter an attempt has been made to calculate the hypothetical gap on current account in 1970 for all developing countries. If the gross domestic product of all the developing countries grows at the target rate of 5 per cent for the development decade of 1960 and 1970 and of the developed (market) economies continues to increase at the same rate of 3.7 per cent per year as in the period 1950-60, then the developing countries are expected to experience a gap on their current accounts in 1970 of about \$20 billion in 1960 prices and exchange rates, after allowing for about \$3 billion exports to the centrally planned economies. The hypothetical projection by extrapolating historical relationships are, of course, based on highly simplifying assumptions. Import requirements of the developing countries are calculated on the basis of simple linear regressions of major commodity imports on gross domestic product or gross domestic fixed capital formation. Estimated exports are obtained by projecting a log-linear relation between the imports from the developing countries and gross domestic product of the developed countries, fitted to the data for 1950-61. The hypothetical level of net payments for investment incomes and other services are estimated by using some assumed proportions to commodity exports. All this is rather crude and the estimates obtained are obviously very rough. But judging from the nature of the data and the level of aggregation at which the whole exercise is performed, I am not

sure how much better can be done. In any case, in spite of their limitations, these projections do provide a general *meaure* of "the broad order of the trade needs of the developing countries."

The policy discussions in these papers are unmistakably partisan on behalf of the developing countries. The basic premise is that the foreign exchange resources of the developing countries have to be raised and the purpose of the conference and of these papers is to suggest ways of doing it. But there is an unstated assumption that it is the developed countries' responsibility that the developing countries should be helped. The support given here to Rosenstein-Rodan's suggestion that the assessment of aid-contributions of different countries should be based on the progressive income tax principle is only an example of this. There is also an implicit general assumption that the economic growth of the underdeveloped countries would in the long run help the developed countries. But coming to specific policy measures, it is often not clear how much the under-developed countries should depend on the philanthropy or on the long-run self-interest of their developed partners. For example a strong case is made for the reduction of tariffs by the developed countries on the basis of free-trade type of argument that it would improve the international division of labour, and would make "more economic the pattern of resource use at the global level as well as stimulate the domestic producers to raise their productivity. But confronted with the contention that in the case of quite a few commodities a straight liberalising measure might not be of much help for those developing countries who will then have to compete with the more productive developed countries, the argument is shifted to "preferential reduction in duty applicable to developing countries". On the other hand, in the case of commodities with very low price elasticities of demand, which are taxed by the importing countries mainly for the purpose of revenue, where lowering of taxes based on import-unit-value may have little effect on the volume of trade, it is earnestly pleaded that there should be a sharing of the proceeds of a fiscal duty on such commodities when they are imported from the developing countries.

The chapter on international Compensatory Financing is probably the most controversial in this volume and

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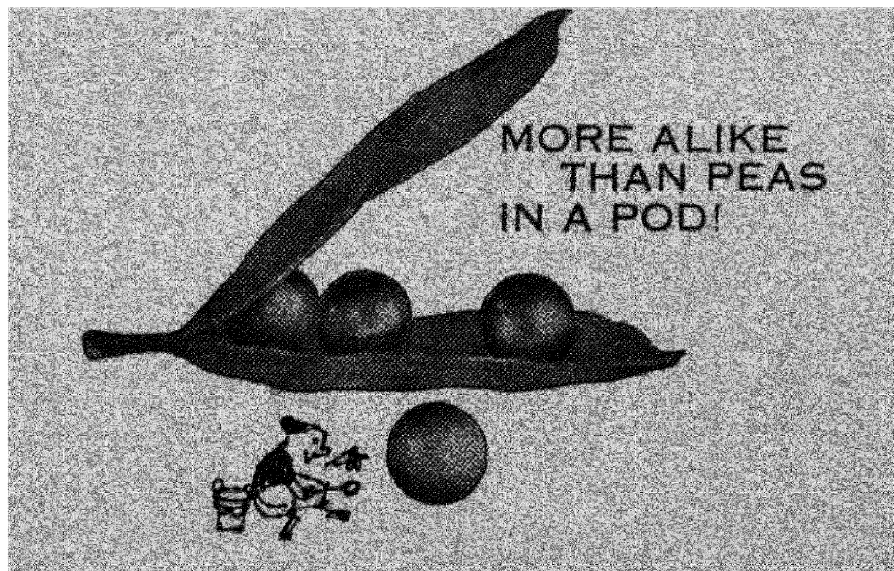
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will surely receive much notice from scholars and policy makers everywhere. Broadly speaking, the rationale of compensatory financing can be discussed as follows- (see pp 284-287): The underdeveloped countries which are mostly exporters of primary commodities, are experiencing for quite some time, not only sharp short-run fluctuations in their export earnings but also a definite downward trend in their terms of trade from 1954 onward. It is recognised that long-run price movements should serve as signals for reallocating investment and productive resources and the developing countries should adjust their composition of exports in response to the price changes. But the developing countries do not have a flexible economy, and any readjustment: in their economic structure or resource allocation will very much depend on the availability of foreign exchange resources. While other international measures might prevent, delay or moderate the decline in prices, an international fund should be created to provide the developing countries some form of compensation for such decline *ex post facto*, specifically to help the process of resource transfer and the needed internal adjustment

#### Automatic System Impractical

Now such a policy at the international level of subsidising the poor performers at the expense of taxing those who have done better could make some sense only if the developing countries were making deliberate efforts to change their structure of production and were able to provide definite evidence for that. It is difficult to see how a case can be made for making the system automatic. Surely it cannot function as an insurance scheme if there is a persistent trend of falling terms of trade for the developing countries so that some groups of countries would tend to be consistent gainers and others consistent losers from such a scheme of compensation.

In any case there are many points of detail of policy and methods of operation that have to be settled before any such scheme can come into effect, and there is scope for picking up quarrel with many of the suggestions made in this paper, including the way it measures the national "loss" due to changes in terms of trade. Further, on the need for standardisation in the measurement of terms of trade, there is a suggestion that while the unit value index of exports could be obtained by considering only the major

items, on the import side, all countries could use a single standard index of unit value of manufactures moving in world trade. Since the developing countries not only export, but also impose substantial amounts of primary commodities, this would surely exaggerate the fall in terms of trade of the developing countries, when the prices of primary commodities are tailing.

Policy discussions in these papers will surely provoke controversy, but that is not the only reason why they deserve the notice of students of international economics. There is a wealth of material presented here about the international trade problems of the developing countries. I have to say about the presentation of the empirical information. The statistical series given here are generally taken from a mimeographed document, to the absence of which little comment can be offered on the quality of the statistics. But in the presentation of the long-term capital flows into the developing countries, there could have been some emphasis on the qualitative difference between different kinds of capital flows. Official grants and all kinds of official loans can hardly be summed together as a measure of official aid. It is difficult to measure the aid content of different types of loans, but some attempt could be made to obtain the difference between the actual value of loans and the present value of the interest and amortisation repayments discounted by some index of market interest rates, to show the broad order of magnitudes. PL 480 funds constitute a significant proportion of the official aid and there has been at least one attempt in the US to value them not in terms of the ruling market price of the surplus commodities but in terms of some estimated prices that would have ruled if these commodities were released in the market, and after making adjustments for the higher freight rates of the US compared to the others.

But all these are minor points and they are really of small significance compared to what has been achieved in these papers. For the first time we have been presented in the compass of a single volume a detailed discussion of the composition and direction of foreign trade of the developing countries which will make an important contribution to the understanding of the network of international trade in the recent period. There is a very able treatment of pro-

blems of stabilisation of primary commodities markets and the role of international commodity agreements. There is an equally competent description and analysis of tariffs and other fiscal barriers and quantitative restrictions on the exports from the developing countries. There is an excellent summary of the problems associated with long-term capital flows to the developing countries, with an analytical presentation of the direction and composition of capital flows and their relations with exports, imports, domestic capital formation and gross domestic product of the developing countries.

#### Gloomy Picture

It is not within the scope of this review article to present a summary of the materials presented in this big volume. But the picture that emerges from it of the position of the developing countries in world trade is rather gloomy. During the last decade there has not only been a marked decline in the share of the developing countries in international trade but also a definite trend that the developed countries are becoming more and more self-contained, and independent of the developing countries. Compared to 1950, the terms of trade of the developing countries in 1961 relative to the world trade declined by 10 per cent, but relative to the developed countries they declined by 14 per cent. Between 1950 and 1960, the unit value of exports of the developed countries increased by 19 per cent, while the quantum of exports increased by 112 per cent, but while the unit value of exports of the developing countries fell by 4 per cent, the quantum increased by only 57 per cent.

During 1950-62, while exports from the developed economies were growing at an annual rate of 8 per cent and from the centrally planned economies at 11.1 per cent, exports from the developing economies were growing only at 3.4 per cent per annum. If we exclude the years of the Korean war and its aftermath exports from the developing countries between 1955 and 1962 were growing only at the rate of 2.8 to 2.9 per cent. This was of course largely due to the fact that 90 per cent of the developing countries exports were primary commodities the exports of which were increasing only at the rate of 2.2 per cent during 1955-61. It is difficult to maintain, however, that deficiency in demand was mainly responsible for this, be-


cause the exports of primary commodities from the developed countries were increasing during this period, at the rate of 5.2 per cent, and, if petroleum and its products are excluded, only about one-third of the developed countries' imports of primary commodities were coming from the developing countries. On the other hand, the developing countries' exports of manufactures were increasing at 6.5 per cent per annum during 1955-61, but this compares not very well with a rate of increase of 8.4 per cent from the developed countries and of 11.9 per cent from the centrally planned economies. Moreover, the magnitude of this rate of increase was very much due to the small initial size of exports of manufactures from the developing countries. In 1961, exports from the developing countries accounted for only about 4 per cent of the world trade in manufactures, and while world exports of manufactures increased by about \$ 25 billion between 1955-61, exports from the developing countries increased by only about \$ 0.8 billion. Add to this the fact that most

of this increase is still contributed by traditional items like different types of textile, carpets and tapestries, wood products and leather.

Comparatively speaking the picture of the net inflow of long-term capital into the developing countries looks brighter. The annual average of such total net inflow was \$2.6 billion during 1951-55, \$4.7 billion during 1956-59, and \$6.0 billion during 1960-62. But this has not basically modified the dependence of the developing countries on merchandise exports as their principal source of foreign exchange. In 1960-62, about 80 per cent of their foreign exchange came from the merchandise exports, of which about 13 per cent was taken up by interest and dividend payments abroad. But more significant are the facts that the flows from the international agencies to the developing countries are increasing rather sluggishly, and that the flows of private capital have shown a *declining* trend between 1956-62. Thus official funds have become increasingly more important as the source of long-


term capital. But well over 50 per cent of such official funds are coming from the United States alone, which implies that if for some reason the U S tends to reduce its contribution, there may be a sharp decline in the inflow of foreign capital to the developing countries.

This unhappy situation of the developing countries and the realisation that their need for foreign exchange is bound to increase rapidly in the near future, especially if there is any effort to increase their rate of growth. It poses a serious challenge to the economists and policy-makers interested in the economics of development. The need for rethinking about the international trade problems of the developing countries has become very urgent. The present volume, by focussing the relevant issues, analysing the practical problems and supplying a wealth of factual material, has made a notable contribution to our knowledge. It will be extremely useful to any student of the international economics of development.



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