

Chapter 5:

International trade and economic development

- **INTRODUCTION**

- Foreign trade is a major source of foreign exchange revenue for a country.
- The foreign exchange earned through exports is used mainly to finance the import expenditure through which we buy our needs from abroad.

• **FOREIGN TRADE AND ECONOMIC DEVELOPMENT**

- The examination of the role of foreign trade in economic development begins with the question as to what economic development is and economic development was equated till recently with economic growth or a rise in the per capita national income.
- A number of Middle East countries are growing at a fast pace, thanks to oil-exports but this sort of one-dimensional growth can hardly be called development.
- Development refers to a qualitative change in the basic parameters of society. Development is a broader and richer abstraction than mere growth may leave the majority of the people in an object of poverty. Growth can take place without development for a long period but growth is only an element, though an essential one, of development.

• **IMPORTANCE OF FOREIGN TRADE**

- From the economic history of the now advanced countries, one can clearly make the tremendous importance of foreign trade. Infact, the great geographical discoveries of the 15th – 17th centuries like the opening of the Americas, the sea route to India, etc. were certainly spurred in part by the necessity of finding the missing links in foreign trade in the form of gold, spices, cloth, etc.
- Infact, there was a school of economic thought called the ***Mercantilists*** who held that wealth would be created in a country primarily by foreign trade.

- The results of the great geographical discoveries led to the colonization of large parts of Asia, Africa and Latin America. The traders soon became colonizers and exploited these areas in terms of natural resources, markets, etc., in order to generate the industrial revolution in the metropolitan countries, especially Britain and France.
- The importance of foreign trade as one of the ***motive forces of economic development*** is now recognized all over the world.

- **TERMS OF TRADE**

- One important question in the whole argument around foreign trade is the terms of trade issue. Historically, prices of goods exported by developing countries were till recently rising at a slower pace than prices of the goods of developed countries.
- This led to a deterioration in the terms of trade for the developing countries and consequently, the *outflow* of resources from the developing countries.
- But since the Oil crisis of 1973, there is evidence that the tide is changing. Prices, especially those of natural resources, are growing more and more and reflect scarcity.
- Developing countries are coming together more and more to collectively enhance the markets. The North-South dialogue is also looking into these problems which, if not solved immediately, could in the long-run assume alarming properties.

- The colonial model of international trade condemned the developing countries to the role of agricultural and natural resource exporters.
- This was based partly on the Ricardian concept of comparative costs where in it was argued that a country must specialize in the production of these commodities in which it had a natural advantage.

• **PATTERNS OF INTERNATIONAL TRADE**

- Firstly, international trade is now more and more characterized by trade in the means of production. That is to say that means of production are occupying a larger place in the total trade turnover. This means that the already developed countries are monopolizing a larger part of the trade.
- Secondly, trade is becoming more science intensive, i.e. the frontier areas of science and technology etc., are coming to define trade flows in a more definite manner. The role of natural resources in international trade is slowly going down, though not in value, at least by unit use due to spurt in synthetics.

• FOREIGN TRADE IN LDCS

- Foreign trade plays a very important role in developing the economies of the LDCs, however, their exports structure is very weak, this is because, 90 percent of their export products are primary agricultural products whose prices international markets are highly fluctuating and decreases, it lacks also diversification and improvements of the volume or quantity and quality of their exports.
- On the other hand, the imports of LDCs are manufactured products of very high cost like machinery, equipment, spare parts, fuel, fertilizer and similar other products.
- Hence, the major problem of LDCs in their trade sector, is how to balance the gap between the imports expenditure and the export revenue, which highly has affected **balance of payments** position.

- Foreign trade possesses great importance for LDCs. It provides the urge to develop the knowledge and experience that make development possible, and the means to accomplish it.
- When a country specializes in the production of a few goods due to international trade and division of labor, it exports those commodities, which it produces cheaper in exchange for what others can produce at a lower cost. It gains from trade and there is increase in national income, which, in turn, raises the level of output and the growth rate of an economy. Thus, the higher level of output through trade tends to break the vicious circle of poverty and promotes economic development.
- International trade widens the market and increases the inducement to invest, income and savings through more efficient resource allocation.

- Economists like **Prebisch**, Singer and Myrdal has criticized that historically international trade has retarded the development of LDCs. **Three** arguments are usually advanced in support of this view that international trade has strong ***backwash effects*** on the LDCs.
 1. Trade operates, (as a rule), with a fundamental bias in favor of the richer and progressive regions, (and confines), and in disfavor of the less developed countries.

- According to the writings of Myrdal, free trade or unhampered trade between two countries of which one is industrial and the other underdeveloped, strengthens the former and impoverishes the latter.
- The rich countries have a large base of manufacturing industries with strong ***spread effects***. By exporting their industrial products at cheap rates to LDCs, they have priced out the latter.
- This has tended to convert the backward countries into the producers of primary products for exports. The demand for primary products being *inelastic* in the export market, they suffer from excessive price fluctuations.

2. In the opinion of Prebisch there has been a secular deterioration in the terms of trade of the LDCs. It implies that there has been an *international transfer of income from the poor to the rich* countries and that the gains, from international trade have gone more to developed countries at the expense of the former, thereby reducing their level of real income and hence, their capacity for development.

3. It has been contended that the operation of the *international demonstration effect* through foreign trade has *adversely affected capital formation in LDCs*. But all of these criticisms are unfounded. There is no empirical evidence to prove that the development of the export sector has been at the expense of the domestic sector. Foreign trade has not always stood in the way of domestic investment. Nevertheless, as pointed out by Nurkse, “even unsteady growth through foreign trade is surely better than no growth at all.”

- The adverse effects of the demonstration effect are also exaggerated. Emulation of higher standards of living and superior consumer goods act as incentives to increased effort and productivity on the part of the people of LDCs.
- It encourages the development of service occupations to supply superior goods. It also exercises a healthy influence in stimulating local initiative and enterprise.
- Again, the adoption of the western consumption standards tends to influence the subsistence sector favorably.

- The incorporation of milk, eggs, vegetables, and fruits in diet induces agriculturists to produce them more for the market in addition to subsistence production.
- It involves the investment of more capital and making improvements in agriculture, dairy and poultry production.
- This also provides increased employment, income and leads to further capital formation.