4.4 The role of international trade

171. Trading problems facing economically less developed countries

→ There are number of international factors that act as a barrier to both economic growth and economic development for economically less developed countries.

IB Question

• With reference to specific examples, explain how the following factors are barriers to development for economically less developed countries. a. Over-specialization on a narrow range of products b. Price volatility of primary products c. Inability to access international markets

a) Over specialization on a narrow range of products

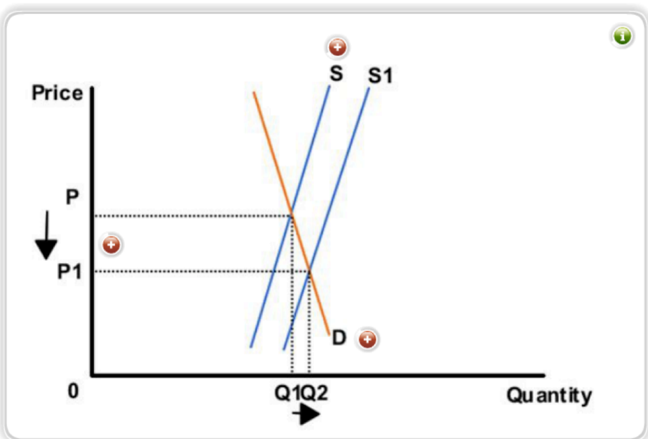
→ Regardless of the types of goods exported (e.g. commodities, manufactured goods and services), if a country is dependent on a narrow range of exports, then they face great vulnerability and uncertainty

→ e.g.) Countries that were dependent on the export of a small range of low-skill manufactured goods such as textiles were damaged when China joined the WTO

b) Price volatility of primary products

→ PED and PES for commodities are relatively inelastic, meaning that there is a large price fluctuation in any change in demand or supply conditions

→ Makes it difficult for producers and governments in developing countries to plan ahead. This in turn has an impact on investment in companies, and thus growth, and on government planning for education, health care and infrastructure, and thus development.



c) Inability to access international markets

Protectionism: any economics policy that is aimed at supporting domestic producers at the expense of foreign producers

- Against free trade and the goals of free trade
- Includes: tariffs, subsidies, quotas, and administrative barriers
- If utilized against developing countries, it could be a great barrier to development, as the country will not be able to trade fully and receive foreign exchange, which is used to import other goods

Protectionism is damaging in the primary product/commodity market.

- US subsidy causes the world price to decrease – harming the exporters in foreign countries
- Dumping could also occur – which is the selling by a country of large quantities of a commodity, at a price lower than its production cost, to another country.

Tariff escalation: when the rate of tariffs on goods rises the more the goods are processed.

- This protects the domestically manufactured good while having low tariffs on the raw material
- This causes developed countries to import raw material from developing countries, refine the raw material, and then export the manufactured good to the developing countries at a higher price and with a higher tariff imposed
- Tariff escalation also makes developing countries shy away from entering the manufacturing market, as these developing countries do not want a higher tariff on their good.

Non-convertible currencies: currencies that can only be used domestically and are not accepted for exchange on the foreign exchange market.

- Most developing countries have a fixed exchange rate pegged to the US dollar and thus are overvalued
- Non-convertibility means that less trade is likely to occur, as traders and investors would not want to take the risk dealing with non-convertible currencies.
- Black market for the convertible currency may arise due to over-valuing currencies

Syllabus item: 172 Weight: 3

171. Trading problems facing many economically less developed countries

IB Question

- With reference to specific examples, explain how the following factor is a barrier to development for economically less developed countries. a. Long-term changes in the terms of trade

Long-term changes in the terms of trade

- Long term changes in the terms of trade can have a marked effect upon the ability of developing countries to trade internationally
- i.e. changes in the relative prices of exports and imports
- If commodity prices are falling over time, and many developing countries are primarily exporters of commodities, then their export revenues, and so their ability to buy imports, will be decreasing

Syllabus item: 173 Weight: 3

173. Trade strategies for economic growth and economic development

→ Growth strategies: economic policies and measures designed to gain growth

→ Development strategies: economic policies and measures designed to achieve human development[

→ Economic growth ≠ Economic development

IB Question

• With reference to specific examples, evaluate each of the following as a means of achieving economic growth and economic development. a. Import substitution b. Export promotion c. Trade liberalization d. The role of the WTO e. Bilateral and regional preferential trade agreements f. Diversification

1) Import substitution (ISI)/ Inward oriented strategy

→ Strategy that says that a developing country should, wherever possible, produces goods domestically, rather than import them

→ Industries producing the goods domestically will be able to grow, as will the economy, and then will be able to be competitive on world markets in the future, as they gain from economies of scale

<<Necessary conditions>>

- The government needs to adopt a policy of organizing the selection of goods to produce domestically (i.e. low-skill manufacturing goods)
- Subsidies to encourage domestic industries
- The government needs to implement a protectionist system with tariff barriers to keep out foreign imports

Advantages	Disadvantages
• Protects jobs in the domestic market • Protects local culture and social habits • Protects the economy from power, and possibly bad influence, of multinational corporations	• May only protect jobs in the short-run • ISI means that the country does not enjoy the benefits gained from comparative advantage and specialization, so producing products relatively inefficiently, when they could be imported from efficient foreign producers • As competition is not there to encourage R&D it may lead to inefficiency in domestic industires • May lead to high rates of inflation • May cause other countries to take retaliatory protectionist measures

2) Export promotion/ Export-led growth

→ An outward-oriented growth strategy, based on openness and increased international trade

→ Where growth is achieved by concentrating on increasing exports and export revenue as a leading factor in the aggregate demand of the country

<<Necessary policies to be adopted in order to achieve export-led growth>>

- Liberalized trade
- Liberalized capital flows
- A floating exchange rate
- Investment in the provision of infrastructure to enable trade to take place
- Deregulation and minimal government intervention

<<Differences involved in using the export of primary or manufactured products as the engine for growth>>

- Export-led growth based on export primary products is unlikely to be achieved because:

→ Overall trend in primary product prices has been downward for many years (except for oil and other metals)

→ Increased protectionism by developed countries

- Export-led growth based on manufacturing products is increasing because:

→ Having comparative advantage, usually based upon low-cost labour

→ Nowadays, sophisticated products using capital-intensive production methods and more highly skilled workers are being exported (Achieved by improvements in education system)

→ Successful countries: Japan, South Korea, Japan, Hong Kong, Singapore and Taiwan (‘Asian Tigers”)

<<Problems associated with export-led growth>>

- The success of the “Asian tigers”, since around 1965k has led to increased protectionism in developed countries against manufacture products from developing countries. Price increases as a result of tariffs effectively removed the comparative advantage of the exporting countries. Also, tariff escalation reduced the ability of the developing countries to export processed goods and assembled products, forcing many to export primary products and low-skilled manufactured goods instead.
- Some countries did not meet necessary conditions → Some argue that the role of state in successful export-led growth is vital and that minimizing government intervention isn’t the way forward (I.e In the “Asian Tigers”, government played an important role)
- If attracting MNCs, there is always fear that MNCs become too powerful within the country and that this way lead to problems
- Export-led growth may increase income equality in the country

3) Trade liberalization

→ Removal of trade barriers that block the free trade of goods and services between countries

→ Involves elimination of tariff barriers, quotas, export subsidies etc.

→ The belief is that trade liberalization will increase world trade and will enable developing countries to concentrate on the production of goods and services in which they have a comparative advantage

→ WTO promotes trade liberalization, and so to encourage free trade

<<Ten common reforms that are necessary for economic growth in developing countries/ Washington Consensus>>

- Fiscal discipline, that is, balanced budgets
- Redirect spending priorities from things like indiscriminate subsidies to basic health and education
- Lower marginal tax rates and broaden the tax base
- Interest rate liberalization
- A competitive exchange rate
- Trade liberalization
- Liberalization of FDI inflows
- Privatization
- Deregulation
- Secure property rights

→ However, these are often criticized.

4) Bilateral and regional preferential trade agreements

→ **Trade bloc:** a group of countries that join together in some form of agreement in order to increase trade between themselves and/or to gain economic benefits from cooperation on some level

→ The belief is that the more agreements that are made, the greater will be the ability of developing countries to trade and so gain growth and, eventually, development

5) Diversification

→ A number of developing countries are now pursuing export diversification as a means to gain economic growth

→ Aim: To increase production and export of manufactured good and semi-manufactured products

→ Goal: To protect themselves from the volatile changes in primary product prices

To stabilize or increase export revenue

To stabilize or increase employment

→ Problem: Practice of tariff escalation

Need for a more highly qualified workforce in order to produce relatively more sophisticated products