EC246-2-AU – Lecture 3

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Strategies for Development, UNCTAD and Non-Tariff Barriers

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Plan of talk

- **Introduction**

1. **Trade and development**
    1. The Prebisch-Singer thesis
    2. Policy response: import substitution
2. **Politics and economics in multilateral trade negotiations**
    1. Nonaligned Movement, GSP, UNCTAD and NIEO
    2. Nontariff barriers as a protectionist tool circumventing GATT
    3. Export price instability and administered markets
3. The shift to **export-led growth policies:** NICs and ASEAN4

- **Wrap-up**

Aim and learning outcomes

- **Aim**: introduce *trade and development* issues, as they reflect the policies of developing countries pursued on the international economic and political arena
- **Learning outcomes**
  - understand the causes of the major economic problems of developing countries
  - describe the historical evolution of their trade-related claims to the industrialised world and evaluate their key development strategies
    - import substitution
    - export-oriented growth
  - define the principal nontariff barriers to trade remaining outside GATT
  - set out the key reasons for the failure of most cartels

Trade and development: main issues

- Is trade “an engine of **growth**”?
  - trade *pessimists (protectionists)*: low-growth demand and adverse ToT
  - trade *optimists (free-traders)*: underplay their role for primary products
- Should LDCs adopt
  - an **inward**-looking **policy** => industrialisation with *import substitution*
  - an **outward**-looking **policy** => *export promotion* with free(r) trade
  - or some **combination** of both?
- Does trade increase international and domestic **(in)equality**?
- **Historical background**: developing countries
  - denounced the pre-Havana draft for an ITO charter as motivated by a desire to keep them *in dependence*
  - included in the final charter adopted by the conference a chapter on economic development seeking *release from commitments*

Trade and development: early theories

- late 1930s
  - **D.H. Robertson**: trade is unlikely to play the role of *an engine of growth* in the 20th century (which it did play in the 19th century)
  - **Jacob Viner**, by contrast, pleaded for a *liberal* trading system
- early 1950s
  - **Ragnar Nurske** applied D.H. Robertson's trade pessimism to the underdeveloped countries of the Third World: *centre* and *periphery*
  - **Raul Prebisch**, *The Economic Development of Latin America and Its Principal Problems*, UN, 1950
  - **Hans Singer**, "The Distribution of Gains between Borrowing and Investing Countries", *American Economic Review* 40 (May), 1950
  - **Gunar Myrdal** (Nobel prize winner in 1974, jointly with Friedrich von Hayek) developed a systematic theory of *trade as a mechanism of international inequality* => a whole new literature of LDCs protectionism grew up: "infant economy" arguments

The Prebisch-Singer thesis

- **Essence**
  - independently of one another, Prebisch (in theoretical work) and Singer (in empirical work) argued that there was and will continue to be a secular **decline in ToT** of *primary-commodity* exporters, itself due to a combination of low *income* and *price* elasticities of demand (cf. slide 15)
  - this decline resulted in a long-term transfer of income from poor to rich countries that could be combated only by protecting domestic *manufacturing* industries through a policy of **import substitution**
- **Illustration**: Fig. 12.1, p. 523, Todaro and Smith (2002, 8th ed.)
- **Result**: the "two gap analysis" literature
  - the "foreign-exchange gap" ≡ export earnings less import requirements (usually calculated to reflect ambitious growth targets) added to
  - the "saving gap" ≡ difference b/n saving and capital requirements of earlier empirical estimates

Policy response: import substitution

- Behind the *protection* of high barriers on manufacturing imports LDCs should **industrialise** by substituting domestic production of previously imported
  - simple consumer goods: 1st stage
  - and more sophisticated products: 2nd stage
- Thus achieving greater domestic industrial **diversification**: “balanced growth”
- And the ultimate ability to **export** such goods as their prices become more competitive owing to
  - economies of scale
  - low labour costs
  - positive externalities of learning by doing
- Do we see this in the **data**? => Fig. 12.2, p. 524, and Fig. 12.3, 525, in Todaro and Smith (2002, 8th ed.)

Why import-substituting strategies of industrialisation proved unsuccessful

- Behind protective walls, many industries (both publicly and privately owned) remain **inefficient** and never grew up
- Gains accrue to *foreign* and *domestic* **manufacturers** (the latter providing political and economic cover for the former via joint venture) under government tax and investment incentives to FDI
- Made possible by heavy and often government-subsidised **imports** of capital goods and intermediate products from abroad => BoP and debt problems => ultimately, low(er) growth
- To encourage such (cheaper) imports, national currencies were often **overvalued** => but more *exports* then became more expensive => local *farmers* less competitive on world markets: income redistribution effect

Nonaligned Movement and Haberler Report

- In **1955**, the **Nonaligned Movement** emerged from the Bandung conference, led by heads of newly independent states of Africa and Asia (Nasser, Nehru, Sukarno) and demanded
  - decolonisation of the remaining dependent territories
  - and an international role of the Third World, independent of the First and Second Worlds and their Cold War
- To analyse trade and development problems of LDCs, a GATT panel of experts was appointed and published in **1958** its **report**
  - the panel was presided by **Gottfried Haberler** and consisted of James Meade (Nobel prize winner in 1977, jointly with Bertil Ohlin), Jan Tinbergen (Nobel prize winner in 1969, jointly with Ragnar Frisch) and Oswaldo Campos
  - the main **conclusion** was that barriers of all kinds in developed countries to the import of products from developing countries contributed significantly to the trade problems of LDCs

Responses to the Haberler Report

- GATT responded by establishing **Committee III** which
  - reviewed the trade measures restricting LDCs exports
  - recommended a programme for trade expansion by reducing barriers
- developed countries did not react by substantially lower barriers
  - ideas for an UNCTAD were gaining support among developing countries, as their number and voting power grew within UN
    - 1961 (Belgrade) nonaligned countries conference: Tito voiced an UNCTAD idea
    - 1962 (Cairo) nonaligned countries conference: the idea got more concrete
  - in the preparations for UNCTAD I, the "Group of 77" Third World member countries of UN became an effective bargaining unit turning the new organisation into a "trade union" of LDCs
- **1963**, GATT **Ministerial Meeting**
  - *proposed* an amendment to GATT to accommodate demands from developing countries
  - essentially about *nonreciprocity* and *preferential* treatment

Generalised System of Preferences (GSP)

- **1964**: the amendment *approved* => a new **Part IV** on *trade and development* included in GATT
- Next major achievement of developing countries: **GSP**
  - the grant of a 10-year waiver from the MFN clause w.r.t. to tariff and other preferences favouring trade with developing countries: what became known as the Generalised System of Preferences (GSP)
  - later included under the rubric of the enabling clause of the Tokyo round which formulated the "differential and more favourable treatment" of developing countries in GATT
  - yet some negative effects: e.g. looser discipline in the rule-based MTNs
- At last, Western countries conceded to pressures from developing countries
  - **EcoSoC dissolved**
  - **to convene UNCTAD**

UNCTAD I

- **1964**, the **1st meeting** of UNCTAD (**UNCTAD I**) was held
  - 75 developing countries, Prebisch as the 1st Secretary-General
  - aim: development-friendly integration of developing countries into the world economy
  - focus: “fair” trade, nontariff barriers and development
- as the best means to close the foreign-exchange gap, UNCTAD I voted nearly unanimously for
  - a **managed international market**
  - and **trade arrangements** that are **“fair”** (in fact, often discriminatory against the developed countries)
- **UNCTAD I initiatives**
  - were supported strongly by the *socialist* countries
  - and moderately by some developed countries, notably *France* and *EEC*
  - but opposed by other developed countries, *US* in particular

UNCTAD since 1964

- UNCTAD meets **every 4 years** at its conference
- The **conference** , normally lasting about *1 week*, is UNCTAD´s *highest decision-making body*
  - sets priorities and guidelines for the *organization*
  - provides an opportunity to debate key *economic and development* issues
- UNCTAD is the **focal point within UN** for
  - the *integrated* treatment of *trade and development*
  - and the interrelated issues in the areas of finance, technology, investment and sustainable development
- Most recent conference
  - **UNCTAD XI**, *held* in June **2004** in Sao Paolo
  - main *theme*: "Enhancing the coherence between national development strategies and global economic processes towards economic growth and development, particularly of developing countries"

New international economic order (NIEO)

- October **1973**: war b/n Israel and Egypt
  - led to a successful **OPEC cartel** action, causing the "first oil shock"
  - which suggested that the Third World was in a position not merely to request but to force industrialised countries to make concessions
- April **1974**: the **6th special session** of *UNCTAD* adopted
  - **Declaration** on the Establishment of a New International Economic Order, broadly formulating 20 demands, among which
    - sustained improvement of ToT for primary products
    - favourable conditions for transfer of financial resources
    - promotion of transfer of technology
    - reform of the international monetary system
    - preferential and nonreciprocal treatment in economic relations
    - full sovereignty over natural resources and right to nationalisation
    - regulation and supervision of the activities of transnational corporations
  - A **Programme of Action** spelled out these demands in more detail
- February **1975**: *Nonaligned Movement* **Dakar conference**
  - the ideological high water-mark of NIEO
  - "the development of the rich capitalist countries is intimately related to the colonial and neocolonial exploitation of the periphery" (Anell and Nygren, "The Developing Countries and the World Economic Order", 1980, p.187)

Third World losing political cohesion

- A last success was the creation of a **UN Common Fund**: the chief plank of the NIEO commodity programme
- Since late 1970s, **economic performance and interests** within the Third World have gradually diverged until cohesion was lost
  - rich Arab OPEC countries
  - newly industrialising countries (NICs) of South-East Asia
  - Latin American countries, some at times more successful
  - low-income countries of South Asia
  - least-developed countries of Africa
- A problem with the NIEO campaign was that it required a better deal for poor **states** (and thus governments), not for poor **people**: foreign aid too often represented a transfer “from the poor in the rich countries to the rich in the poor countries”

Non-tariff barriers circumventing GATT

- **Quotas ≡ quantitative restrictions (QRs) -** see earlier slides
- **Tariff quotas** ≡ a mixture of a quota and a tariff
- **Prohibition ≡ ban ≡ embargo**
- **Subsidies** ≡ a payment by government, perhaps implicit, to the private sector in return for some activity that it wants to reward, encourage, or assist
- **Countervailing duties -** see earlier lecture slides
- **Antidumping duties -** see earlier lecture slides
- **Voluntary export restraints (VERs)**: a restriction on a country's imports that is achieved by negotiating with the foreign exporting country for it to restrict its exports
- **Technical barriers** to trade (*regulations* and *standards*) ≡ a technical regulation or other requirement (for testing, labelling, packaging, marketing, certification, etc.) applied to imports in a way that restricts trade

Export price instability

- An important clue as to why the export performance of LDCs has been weak relative to that of developed economies lies in **LDCs' export earnings instability**
- It is the result of **two phenomena** observed in trade data
  - low *income* elasticity of the demand for primary products: estimates
    - 1% ↑ in developed-country incomes => 0.6% ↑ in their import demand for foodstuffs ↔ 1.9% ↑ for manufacturers
    - 1% ↑ in developed-country incomes => 0.5% ↑ in their import demand for agricultural raw materials (e.g. rubber or vegetable oils) ↔ 2.4% ↑ for petroleum products and other fuels
  - *price* INelasticity ($0 < \varepsilon < 1$ means INelastic) of the demand for primary products (recall also the definitions for the various types of elasticity)
- Such export price instability leads to *lower* and *less predictable* rates of *economic growth*, hence attempts for **price stabilisation**

Administered commodity markets

- **International commodity agreements**: attempts by countries or producer *groups* to manipulate their ToT via policy instruments such as, most frequently, *buffer stocks* and *cartels*
- **Primary-product cartels** became prominent after WW I but most of them soon failed for want of 1 of the following *4 conditions* for a successful cartel known from theory
  1. it must face a price-*inelastic* demand (no actual or potential substitutes)
  2. *all* important producers must join the agreement
  3. members must be willing to cut back production and an *enforcement* mechanism must be found to curb incentives to cheat (once price exceeds their marginal costs)
  4. buyers must be *unable* (at least disinclined) to fight such monopoly rents
- Similar agreements (for **tin**, **coffee**, etc.) after WW II existed only shortly as well, no matter the policy instruments employed

The alternative of export-oriented growth

- since the 1970s, a tendency to **switch** from import-substituting industrialisation *to export-oriented growth* in development strategies started to gradually dominate the Third World
- (South) Korea, Taiwan, Hong Kong, Singapore ⇔ **Asian NICs** ("tigers") exemplified this shift in their story of success
- Thailand, Malaysia, Indonesia, Philippines ⇔ **ASEAN4** followed suit although in an own way, being part of the Association of South-East Asian Nations (ASEAN)
- What was achieved (CFJ, p. 268) => **end to the Third World?**
  - *per capita income* (1980 USD): NICs, from 974 (1963) to 5162 (1988); ASEAN4 from 606 (1963) to 1546 (1988)
  - *world trade share* (%): NICs, from 1.9 (1963) to 7.7 (1988); ASEAN4 from 1.1 (1963) to 2.1 (1988)

Concluding wrap-up

- **What have we learnt**
  - identify the roots of the economic problems of developing countries
  - evaluate their strategies in the attempts to overcome backwardness
    - import substitution: reasons for failure
    - export-led growth: NICs and ASEAN4 as a success story
  - describe the historical context that gave rise to UNCTAD and NIEO
  - distinguish the principal nontariff barriers to trade circumventing GATT
  - understand some mechanisms to manipulate prices and ToT and the conditions for their stability
- **Where we go next**: to the economics of preferential arrangements such as EU and NAFTA