Week 8: Trade Policies for Developing Countries (Ch.14)

1. Introduction

- Over 5 billion people live in developing countries
- Fortunes of these countries have varied widely (see Figure 14.1):
- Some have achieved super growth, while others have suffered declining es
- In one-fifth of the developing countries, e per person has declined between 1990 and 2005
- Do differences in trade policies play a role?

Figure 14.1:Growth rates

Region or Nation	Annual Growth Rate in Per Capita GDP, 1990–2005	Per Capita GDP, 2005 (at international dollar prices)
23 Industrialized Countries	**1.8**	**34,261**
United States	2.1	41,674
Canada	2.2	35,078
Australia	2.5	32,798
United Kingdom	2.5	31,580
Germany	1.4	30,496
Japan	0.8	30,290
165 Developing Countries	**3.0**	**4,601**
33 Latin American and Caribbean	1.2	9,056
20 Arab States	2.3	6,378
28 East Asian and Pacific	5.8	4,678
9 South Asian	3.4	2,467
45 Sub-Saharan African	0.5	1,825
28 Transition (Central and Eastern European and Central Asian)	1.4	10,417
Selected Developing Countries		
South Korea	4.5	21,342
Saudi Arabia	0.1	21,236
Hungary	3.1	17,014
Poland	4.3	13,573
Chile	3.8	12,274
Equatorial Guinea	16.6	11,999
Russia	−0.1	11,861
Mexico	1.5	11,317
Argentina	1.1	11,076
Mauritius	3.8	10,155
Brazil	1.1	8,606
South Africa	0.6	8,477
Thailand	2.7	6,869
China	8.8	4,091
Paraguay	−0.6	3,905
Indonesia	2.1	3,234
Philippines	1.6	2,932
Pakistan	1.3	2,396
India	4.2	2,126
Nigeria	0.8	1,892
Tajikistan	−4.0	1,413
Bangladesh	2.9	1,268
Ghana	2.0	1,225
Congo, Democratic Republic of	−5.2	264

Note: Measures of gross domestic product per capita adjusted for purchasing power parity (at international dollar prices) are better than the often-cited estimates of average dollar incomes based on exchange-rate conversions. The purchasing power parity estimates reflect the ability to buy a broad range of goods and services at the prices prevailing in each country, whereas using exchange rates to convert other-currency values into U.S. dollars misleads by reflecting only the international prices of goods that are heavily traded between countries. As a rule, comparisons based on exchange-rate conversions overstate the relative poverty of low-income countries by failing to reflect the cheapness of their nontraded services. For more on purchasing power parity, see Chapter 19.

Sources: Growth rates from United Nations Development Program, *Human Development Report 2007/2008*, Table 14. Per capita GDP from World Bank, *2005 International Comparison Program, Tables of Final Results*, February 2008, Summary Table.

2. Trade policy options

- What should a government of a developing country, say Ghana, do to reverse stagnation. Trade policy choices are:
  - Exploit the country's comparative advantage in land and natural resources (i.e. cocoa, coffee gold etc.) without restricting imports or encouraging exports.
  - Attempt to enhance the gains from exporting primary products by raising the world prices of these products by itself (if it is a large producer) or through an international cartel

2. Trade policy options

- Restrict imports and subsidise new industries serving the domestic market
- Encourage the development new industries whose products can be readily exported

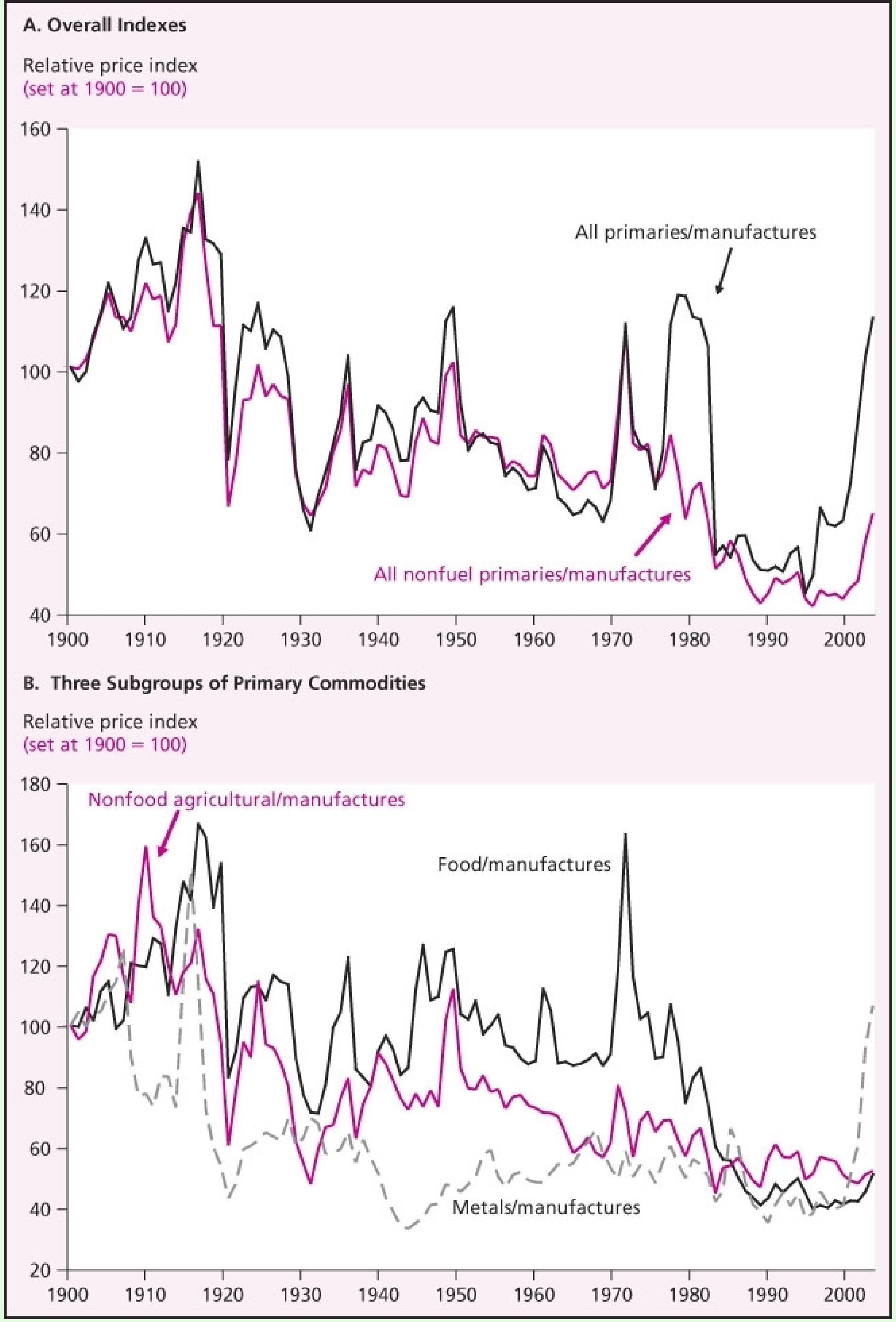
2. Trade policy options

- Trade policies may be justified on the grounds that:
  - Capital markets work less efficiently in developing countries (one reason is that property right are less clearly defined)
  - Labour markets work less efficiently in developing countries

3. Terms of trade in the long run

- Many developing countries export primary products
- In the 1950s, Raul Prebisch argued that developing countries experienced declining terms of trade for primary products (see Figure 14.2)
- TOT=(Index of X prices)/ (index of M prices)
- Therefore, developing countries are trapped into declining es relative to the industrialised world.

Figure 14.2:TOT



3. Terms of trade in the long run

- Forces that decrease the terms of trade for primary products
- Engel's law: As per capita es rise, demand would shift away from food towards luxuries
- Synthetic substitutes: The development of new human-made substitutes for natural materials
- Forces that raise the relative price of primary products
- Nature's limits
- Relatively slow growth in productivity in the

4. Import substitution industrialisation (ISI)

- If TOT is declining, then development requires cutting reliance on exporting primary products and adopting policies (i.e. tariffs and subsidies) that produce substitutes for imported manufactured goods
  - Stage 1: produce simple and inexpensive products such as toys, clothing and canned food.
  - Stage 2: move onto more complex products such as cars and domestic appliances
  - Stage 3: produce complex industrial goods such as chemicals, electronic equipment and machine tools