TRADE AND DEVELOPMENT POLICIES

LEADING ISSUES FOR THE 1980s

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1 Trade and Development Issues for the 1980s

Over the last several decades, economists have debated the relevance of two alternative strategies for developing countries to achieve industrialisation and growth. One camp, whose spokesmen included a number of prominent Latin American economists, stressed the potential advantages of growth through 'import substitution' policies. This strategy suggests high tariff and nontariff barriers be erected around domestic industries to replace foreign supply. Under a protective umbrella of artificial trade restraints, it was theorised that local firms would have the opportunity to achieve economies of scale associated with larger production volumes, or to lower unit costs through specialisation or factors associated with the learning curve. However, a number of practical disadvantages often resulted from attempts to apply import substitution policies with the result that this strategy has experienced declining professional favour.[1]

While import substitution has fallen in esteem, 'outward-oriented' strategies for industrialisation and growth have been increasingly advocated. Under an outward-oriented strategy, LDCs are advised to reduce artificial trade restraints and open the domestic economy to the stimulating effects of foreign competition. Also, domestic producers are encouraged to take full advantage of export opportunities in foreign markets and thereby experience gains that would not be achieved if output were geared solely to domestic demand. Keesing (1967) lists four potentially favourable influences of such a strategy: increasing returns connected with economies of scale and market size, learning effects and the improvement of human capital, beneficial effects from competition and close communication with other countries including the familiarisation with advanced techniques from abroad, and potentially favourable demonstration effects.

Without doubt, the enthusiasm for the outward-looking approach was kindled by the success of countries such as Korea, Hong Kong, Taiwan and Brazil which adopted such policies, as well as accomplishments in the area of trade liberalisation over the previous two decades.[2] In 1968, the Kennedy Round negotiations produced agreement on a broad series of tariff cuts which significantly reduced import duties on a wide range of products exported by developed and developing countries. Generalised System of Preference (GSP) schemes were also launched by developed market economy countries (DMECs) in the early 1970s under which some LDC exports are admitted to industrial markets duty free, or at rates below MFN tariffs. While little progress was made on important issues such as agricultural protectionism or the reduction of nontariff barriers, the outlook through the early 1970s was still for freer market access and trade liberalisation.

For several reasons, there is now considerably less optimism concerning removal of trade barriers and the success of export-oriented growth policies. The growth of industrial countries, which had been sustained at relatively high rates during the previous two decades, fell off sharply in 1974 and has failed to return to previous levels. The international monetary system, based on fixed parities and the convertibility of currencies into gold, has collapsed, with the result that unstable exchange rates and disequilibrating movements of capital are a common occurrence. High rates of inflation persist in many developed nations in spite of continuing conditions of slack economic activity, while unemployment remains high by historical standards. Many industrial countries have not adjusted to the higher energy costs resulting from continuing Organisation of Petroleum Exporting Countries' price increases. In response to these adverse economic developments strong sentiments for increased protectionism have surfaced with new trade restraints applied in a variety of key sectors such as steel, shipbuilding, textiles and electronics. The nature and products covered by these restrictions are such as to have serious detrimental effects on the potential export earnings and industrialisation prospects of developing countries.

These and related developments accent the need to re-evaluate basic trade and development strategies for the 1980s. For example, in a related study Arthur Lewis (1978) compiled historical series which show that the period following the culmination of hostilities in Korea up to the early years of the 1970s marked a truly remarkable interval for international trade and economic relations. Over 1953–73, Lewis showed that world trade expanded at an annual rate of 8 per cent, while trade in manufactures grew by 11 per cent. In comparison, the normal rate of growth in trade prior to this interval was much lower; 3·5 to 4 per cent during 1813–1900, and about 1 per cent per year over 1910–40.

Thus, the expansion in post-war trade was unmatched by similar rates of growth in previous eras.

These developments, rising protectionism, continuing sluggishness in developed market economies, and the realisation that the trade expansion of the 1960s and early 1970s may have been a historical anomaly, have important implications for future development policies. Specifically, if rapid expansion and liberalisation of world trade are not carried over into the 1980s it will be necessary to re-examine the advantages of import substitution as opposed to outward-oriented growth strategies. Also, growing protectionism in DMECs places a premium on new outlets for LDC manufactures. As such, trade and other forms of cooperation among developing countries themselves, or between LDCs and socialist nations, should have a much higher priority than during the 1960s and 1970s. Existing international institutions such as the General Agreement on Tariffs and Trade, the International Monetary Fund, or the United Nations Conference on Trade and Development are also likely to require considerable modification in response to conditions in the 1980s.

SELECTION OF ISSUES: THE LDC VIEWPOINT

Two important documents effectively summarise the developing country viewpoint concerning the major trade and development issues for the 1980s: a special report by the Secretary-General of UNCTAD (May 1976) discusses a broad range of development problems that will require solutions in the next decade; in addition, an UNCTAD (July 1978) symposium of prominent economists and government officials was convened specifically for the purpose of identifying the major issues that would face LDCs during the 1980s. As background, the panel suggested that the main current problems are: the continuing sluggishness of economic activity after the 1974–6 recession, the associated slowdown in world trade, the persistence of historically high rates of unemployment and inflation, the maldistribution of current account payments balances, and the instability of exchange rates. All of these factors were thought likely to pose continuing problems for the 1980s. Structural factors such as the collapse of the international monetary system established at Bretton Woods, the breakdown of the GATT trading rules (manifested in the increasing share of world trade accounted for by intra-firm transactions and new forms of protectionism which bypass GATT rules), the emergence of chronic shortages of key resources such as energy and food, and the decline of some developed country industries were also predicted to be of continuing importance during the next decade.

Given these basic problems, the UNCTAD panel considered their policy implications and solutions. While there was a lack of consensus on some issues, the following points emerged from these deliberations:

—From the LDCs' viewpoint, the present world situation required a fundamental *restructuring* of international economic relations and not merely traditional measures to stimulate recovery in the industrial countries. Several specific proposals were advanced, including: a redeployment of industries from developed to developing countries; a more equitable control over science and technology; institutional changes such as reform of the international monetary and financial system; establishment of international commodity agreements; measures for regulating the activities of transnational corporations; and the promotion of collective self-reliance among developing countries.

—A majority of the participants felt that access to developed country markets would be a vital issue for the 1980s since the benefits include opportunities to exploit economies of scale in production, and comparative advantages in the manufacture of certain products, notably processed primary commodities. It was argued that, in imposing 'voluntary' export restrictions on developing countries, and in applying import restrictions under the GATT 'safeguard' clause, developed countries were discriminating against LDCs. It was also noted that developing countries which were just beginning to export manufactures would suffer most from these measures in the 1980s.[3]

—Considerable attention was devoted to the question of 'collective self-reliance' which many felt would be a major issue for the 1980s. Three aspects of this strategy were discussed: measures aimed at achieving political solidarity, improving the developing countries' negotiating position with industrialised nations, and an expansion of economic transactions among LDCs. However, a divergent view envisaged collective self-reliance as a process by which the LDCs would 'delink' (detach) themselves from developed countries to escape conditions of enforced integration into the world economy under conditions of 'unequal exchange'.

Thus, according to the UNCTAD panel, as well as the report of the Secretary-General of UNCTAD, collective self-reliance, unequal exchange, market access, and the search for new outlets, will be among the most pressing problems confronting developing countries in the 1980s.

In considering the potential impact of LDC industrialisation, Alfred Maizels (1979) foresees major changes for existing institutions and the world economy during the next decade. Specifically, Maizels suggests that the industrialisation of the underdeveloped countries to anywhere near the levels attained by the present DMECs will involve vast changes in resource use, patterns of production, consumption and trade, and in socio-economic structures. Changes in relative prices and in the terms-of-trade between nations will also be involved.

Maizels concludes that the existing international economic system, built on a vertical exchange of commodities for manufactures, may have serious problems in adjusting to a two-way flow of manufactures between developed and developing countries. Such an adjustment would not seem a likely result of the normal working of market forces, rather positive and complementary policies by both developed and developing countries would be involved. A key element for the LDCs centres on the promotion of structural change in their own economies to facilitate the expansion of intra-trade. The developing countries also need to pursue appropriate domestic policies such as the mobilisation of their resources to meet the elementary needs of their populations, and to exploit potential complementarities of their economies by closer economic cooperation. Establishment of such a 'self-reliant' strategy would also strengthen the countervailing power of the LDCs against transnationals, and help to ensure that these corporations' activities promote economic development.

In assessing the potential obstacles to these institutional and economic changes, Maizels is highly concerned with activities of transnationals. Specifically, he suggests that:

> while there is insufficient information available to make any precise assessment of their role in manufacturing and exports of developing countries, these corporations now seem to have a major influence on the pace and pattern of industrialisation in the majority of developing countries. It is also held that these corporations have established effective control over a large and growing portion of LDC export trade. This trend has been accentuated by the growing network of trade barriers imposed by developed countries on the traditional manufactured exports of developing countries.

Interdependence or structural change

A key question to be resolved concerns the nature of the trade and development policies for the 1980s. One school of thought is the 'interdependence' approach which holds that by improving and co-ordinating the functioning of the international economy, within the context of existing economic and political institutions, maximum achievable benefits will accrue to both developed and developing countries. However, this approach has been effectively challenged on the ground that the historical record shows such action holds little promise for LDCs. For example, during the 1960s and early 1970s the international economy was operating at what now seem to be high levels of efficiency, yet the position of most developing countries was static or deteriorated. If the LDCs could not achieve basic development objectives in the favourable economic climate that prevailed in this period, this suggests that major changes are needed in international economic, social, and. political institutions since the longer-term international economic outlook suggests that it will be difficult to return to conditions prevailing in 1960–73.

Perhaps the major policy paper presented to the fifth session of the United Nations Conference on Trade and Development (UNCTAD (May 1979)) argued forcefully and convincingly for the need for basic institutional changes in international economic relations. The report began by noting that the existing international economic system has not provided adequate support for developing countries over the last two decades. Even before the onset of what was the worst post-war recession in 1974, it was apparent that the International Development Strategy for the Second United Nations Development Decade was likely to be a failure. Over 1970–3, economic expansion was largely concentrated in medium and high income developing countries. The poorer nations, with over half of the third world's population, achieved an annual growth rate of about 2 per cent, which was about equal to their population growth. As a result, these countries failed to achieve practically every target of importance in the UN International Development Strategy. That such failures occurred in a period of impressive growth in most DMECs was a source of concern and loss of confidence that growth could be transmitted from developed to developing countries, at least within the confines of existing economic institutions.[4]

After 1973 the debate concerning the nature of appropriate development policies intensified since LDC economic conditions deteriorated from what were already unsatisfactory levels. Over 1974–5, growth in the more advanced LDCs fell sharply, while per capita output in the poorer countries was static or declined. UNCTAD (May 1979) notes these developments 'brought increasing recognition of the need for radical changes in the institutional framework of international economic relations, and it was in this climate that the General Assembly adopted in 1974 the Declaration and Programme of Action on the Establishment of a New International Economic Order'. Since this document has key implications for the types of institutional economic reforms needed, it is reproduced in an appendix to this book.

Given the proposition that third world economic development cannot be accelerated without restructuring the existing international order, it appears that the preoccupation of the DMECs with their own continuing domestic economic problems have diverted attention from the need for such reforms. In fact, the emphasis placed on domestic economic recovery has some negative implications for implementation of basic institutional changes.

The current accent on domestic economic recovery carries with it the implicit assumption that the key to international problems lies in the economic recovery of the industrialised nations, and the consequent expansion of the international economy and trade. This line of reasoning essentially argues for a return to the international processes at work before 1974, i.e., for a continuing of the existing system restored to its pre-recession levels with some marginal adjustments. In this schema, the third world's development is dependent on the transmission of growth from the developed countries via the expansion of the latters' markets, and the resulting increase in demand for raw materials and other LDC products. Emphasis on economic recovery in the DMECs also suggests that the current crisis is essentially cyclical and that economic recovery in developed countries can be achieved independently of basic structural reforms in international institutions. However, the main problem with this (interdependence) line of reasoning is that LDCs were not able to achieve development targets in the pre-1974 period so it is difficult to see what they might gain by any return of industrial countries to these former levels of economic activity.

Another difficulty with the 'interdependence' approach is that it fails to recognise the tie between the current economic difficulties of the DMECs and the imbalances between developed and developing countries. In other words, it ignores the potential contribution of a substantial strengthening of the LDC economies, with a corresponding increase in their purchasing power, to the current economic problems of developed countries. Increasing LDC purchasing power would be a particularly effective way of raising demand for developed countries' capital goods industries which have been operating at very low levels of capacity utilisation.