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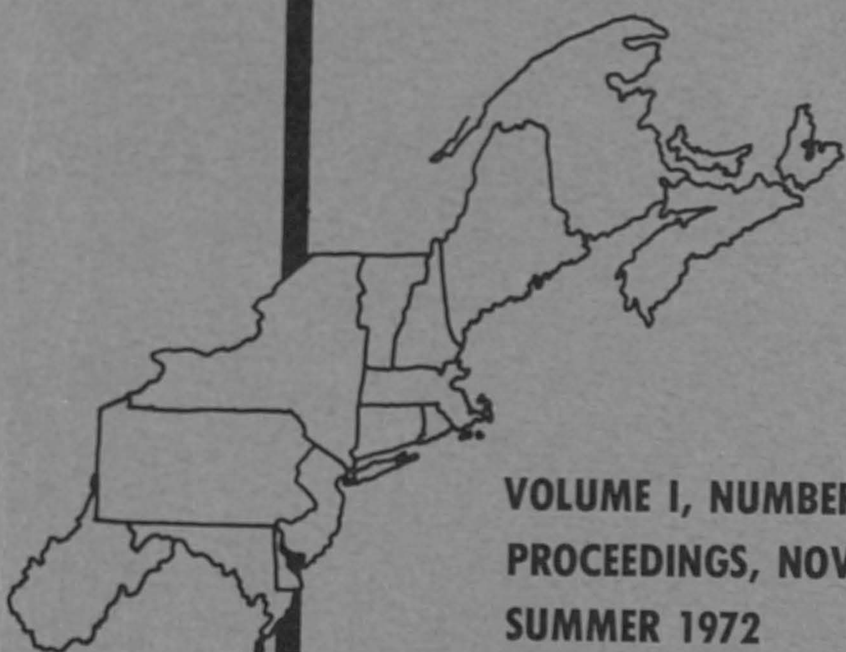

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INTERNATIONAL TRADE AND ECONOMIC DEVELOPMENT HISTORY, TREND, AND APPLICATION

Falih Al-Shaikhly
Department of Finance
American International College

Introduction

Classical economists differentiate between international and domestic trade on the assumption that perfect mobility among factors of production exists within a nation. This is a dynamic analysis. It assumes, however, a static model in terms of the immobility of factors of production between nations. J. S. Mill used such an analysis in his discussion of colonies and considered them part of the mother country, e.g. the West Indies was part of England. Mill stated that factors of production moved freely between England and her colonies.

In recent decades, movement of some factors of production internationally was maintained. Immigration of labor force has been an important part of the economic life of the United States and currently is of great significance to the economic development of Australia and Argentina.

The compatibility of the classical doctrine in terms of economic development (especially the development needs of today's economically less-developed nations) has been exaggerated out of proportion and one borders on redundancy by discussing it. The objective of this paper is to analyse the compatibility of comparative cost analysis with development in terms of trade between developed countries, trade between developed and less-developed countries, and trade within the less-developed nations.

Trade Between Developed Countries

The comparative cost doctrine states that participation in international trade on the basis of comparative cost differences is advantageous. It assumes a labor theory of value and constant cost and deals with already developed countries such as England and Portugal. The doctrine shows that both England and Portugal benefited in terms of international trade specialization during the Ricardian period. These countries were able to produce both wine and cloth before the introduction of trade. Thus, an advanced state of development was to be a precondition of international trade specialization. Each country was able to enjoy a higher real income by specializing in production according to its comparative advantage and ability to trade. J. S. Mill emphasized that trade, according to the comparative advantage doctrine, will result in a more efficient employment of the productive factors of the countries of the world. Therefore, according to him, there is a direct economic advantage from foreign trade, since a country will not only produce for its own market, but for the foreign market as well. This, in turn, will extend the division of labor, promote greater use of machinery, and encourage inventions and improvements in the processes of production.

Classical economists emphasize that a free trade policy has to be followed. This view is also shared by Paul A. Samuelson. He states that free international trade or some trade is to be preferred to no trade at all.[1/]

The Ricardian analysis raises some criticisms by other economists. According to the labor theory of value, the price of a commodity is equal to the relative cost of labor embodied in it. This is a normative analysis. In the event that positive economics is introduced, however, this theory runs into trouble. By introducing the cost of factors other than labor, such as land and capital the price of the goods will not only be proportional to the relative cost of labor needed to produce this product, but will be proportional to the cost of labor, land, capital and other factors of production.

Classical economists hold that international trade can make an impressive contribution to a country's economic development. Trade was considered to be not only a device for achieving productive efficiency, but also an engine of growth. When a country specializes according to its comparative advantage price ratio, the gain generates an increase in the real income of the country and an upward shift in its production possibility curve. Classical economists do not consider the conflict between the gains from international trade and the gains from economic growth. They believe that international trade and growth are integrated.

Classical economists tell us that free trade maximizes world welfare. The fact remains, however, that an individual country may not gain in spite of the emphasis on this doctrine. In this situation, an individual country may better itself under a restrictive policy. R. E. Baldwin points out that a tariff can lead to a greater consumption of both exportable and importable goods than under free trade providing that the foreigner's reciprocal demand curve is not infinitely elastic, and production is carried on under increasing costs.[2/]

1/ Paul A. Samuelson, "Welfare Economics and International Trade," (American Economic Review, June, 1938), as cited in, The Collected Scientific Papers of Paul A. Samuelson, edited by Joseph E. Stiglitz, (Cambridge, Massachusetts: The M.I.T. Press, Volume II, 1966), P. 779.

2/ Robert E. Baldwin, "The New Welfare Economics and Gains in International Trade," Quarterly Journal of Economics, February 1952, P. 93.

From the limitations noted above, let us go on to note the developments that took place in the area of international trade and economic development. Viner agrees with the classical school and adheres very closely to the labor theory of value by claiming that in many respects one can regard labor as the main cost and regard capital as past labor. Haberler does not agree with this analysis. He tries to use community indifference curves to explain the welfare aspect and to show that some trade is better than no trade. He looks to the comparative advantage in terms of money costs. The prices of factors of production are equal in all industries. The exports of a country will be determined by relative money prices of the commodities. This Haberler philosophy is a theoretical one and does not apply to practical trends in international trade. Distortions in terms of tariffs and international political limitations, limit the application of the general theory of international trade.

The Heckscher-Ohlin thesis shows how countries devote their resources to the export sector and explains the relationship between factor endowments and the theory of comparative cost analysis. A country specializes and exports those goods which are produced with relatively large amounts of its abundant factor. The U.S. exports capital intensive commodities, because capital in the U.S. is relatively cheap. But Leontief does not accept this analysis on a statistical ground. In 1947 Leontief used input-output data to test the Heckscher-Ohlin theory and found that the U.S. tended to import capital intensive commodities and export labor intensive goods. Leontief tested the same theory in 1951 and showed the same results. However, there is a technical problem in that he uses coefficients of capital and labor which are averages of industries. Labor coefficients in import industries are higher than in export industries and this weakened his approach. Leontief's analysis did not cover the entire U.S. economy. He also judged the foreign economy on the basis of the American technological experience.

On the whole, further scientific research is needed in the area of international trade and economic development to explain the effects of trade on development within developed countries. Comparative cost analysis is not a sufficient tool to explain the relation of trade and development in a world where perfect competition does not exist.

Trade Between Developed and Less-developed Countries

The conclusion of the comparative costs doctrine is that international trade stimulates a country's economic development. Trade will have a direct effect on the domestic factor supply of the less-developed country. Savings will be increased as real income rises through the more efficient allocation of resources which are associated with opening trade. Investment, then, will be increased as a result of the increase of foreign demand that trade brings. But the adherents of Say's Law are aware of the fact that people do not spend their whole income on consumption. Part is saved and these savings do not buy consumer goods. However, this need not disturb the circular flow of purchasing power. For if the savings are entrusted to businessmen who buy capital goods for them (i.e., invest the savings), the total sales of consumer goods and capital goods are again equal to total production. If investment lagged behind savings, then the rate of interest would fall. Lower interest rates would reduce the incentive to save on the one hand, and on the other would stimulate investment in plant and equipment. This process of increased investment would go on until the equality of saving and investment were restored.

Keynes took a different stand. He showed that an increase in the rate of saving does not necessarily lead to increased purchases of capital goods but sometimes leads to a disturbance in the flow of incomes, which, in turn may lead people to spend less on consumer goods. The aggregate of savings for the year 1971 in the U.S. was increased to 8.2 percent above the normal rate of 5 to 6 percent. If people consume less, business has no incentive to invest more in plants and new machinery, even if the rate of interest is lowered. Total outlays for consumption and capital goods may decline. If this happens, income also declines, because income is earned in production. If income goes down, so do savings. Eventually, the amount of savings are brought into line with that of investments, but not because the rate of interest has brought them to a new equilibrium. This Keynesian analysis is applicable to a highly developed economy as the U.S.A. But the marginal propensity to consume is very high in less-developed economy. As income increases, people shift their consumption patterns. Capital investment by these countries is maintained either through loans from abroad and/or by receiving foreign currencies in return for their exports.

It is not possible to generalize from the experience of any one country. John C. Fei and Gustar Ranis stated this fact by pointing out that: "Some Southeast Asian countries are in a position to export food while many others must import a considerable proportion of their consumption requirements. Venezuela exports oil; other Latin-American countries import it. Such impressive instances of international comparative advantage as tin in Bolivia, guano in Peru, rubber in Malaya, may, after all, be viewed as historical accidents for which it is hard to find parallels, and from which it may thus be difficult to generalize."3/

Some countries import certain products due to the shortage of their internal supply and the greatness of the demand for them. But while this is being done, a country should specialize in producing certain products according to the availability of its resources. Kuwait, for

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3/ John C. H. Fei and Gustar Ranis, Development of the Labor Surplus Economy, Theory and Policy, (Homewood, Illinois: Richard D. Irwin, Inc., 1964), P. 290.

example, produces a large exportable amount of oil and imports agricultural and industrial products from abroad. England, likewise, is an industrial country whose agricultural supply is not enough to meet its internal demand. So, England imports part of its agricultural supply from abroad. Some less-developed economy's export sector may be characterized as being typically composed of the processing and export of one or a number of natural resource-specific commodities. This is largely due to an act of nature, the overseas area enjoys conspicuous absolute, as well as comparative, advantage. This is true for some countries such as Kuwait which is just a desert area. Its absolute and comparative advantages are to specialize in the production of oil.

K. E. Berrill claims that after a less-developed country becomes part of the international economy, its production increases but mainly in the direction of producing for export. For the less-developed countries, international trade has frequently been much easier and earlier than specialization among regions within their own countries.[4] As these countries integrate in the international economy, their production for export will be expanded.

The expansion of the export sector of the less-developed economy mainly consists of foodstuffs and raw materials for which there is a demand induced by the growth of richer countries. In England, for example, as the industrial revolution took place, the demand for the import of foodstuffs and raw materials increased as the industrial output increased. Some of these foodstuffs and raw materials were needed as inputs in the production of final outputs. So the richer countries followed their own comparative advantage in industry, by specializing in certain goods and importing some inputs from abroad. The less-developed countries, before opening international trade, were living in a closed economy. Each country produced only what was needed to satisfy its internal demand.

The expansion of exports may result in better usage of land and advancement of production techniques. Large amounts of capital inflow came from overseas and concentrated on the development of primary products for export. Foreign investments coupled with efficient foreign management and advanced production techniques led to the increase of the productivity of the labor force in the export sector of the economy. So, if there was a surplus of labor force, this surplus moved away from the rural export sector to the urban areas of the economy. In many less-developed countries problems were created because overpopulated urban areas had a shortage of food supply.

4/ K. E. Berrill, "International Trade and the Rage of Economic Growth," Economic History Review, April 1960, P. 352. This Berrill idea is of unbalanced growth approach. The promoter of the unbalanced growth approach is Albert O. Hirschman. See A. O. Hirschman, The Strategy of Economic Development, (Forge Village, Massachusetts: The Murray Printing Company, July, 1964).

When foreign entrepreneurs go to less-developed countries they specialize, from the Heckscher-Ohlin theory point of view, in the production of those commodities for which the country has abundant resources. In the plantation industry the job is simple since it requires a hugh untrained labor force. Plantations have a very low capital factor coefficient. The mineral industry on the other hand, is not a labor intensive commodity; it has a very low labor coefficient. This industry requires an intensive amount of capital and a skilled, trained labor force. These trained people usually come from developed countries which often help to train local people. The mineral industry often leads to secondary benefits for the less-developed country. In establishing a mineral factory, one needs to build transportation facilities to ship resources to the export markets. This will help other local industries to engage in building these transportation facilities, and increase the employment level internally. Transportation facilities are very important in these mineral industries. In South Africa there is no area that is not within fifty miles of a railroad. This is due to the fact that gold is a very small but expensive industry.

The argument against international trade as an engine to generate economic growth for less-developed countries is that the developed countries have exercised their monopoly powers to bring about a significant long-run decline in the terms-of-trade with less-developed countries. The less-developed countries have no monopoly power collectively to influence the prices of their goods. The prices of their primary commodities fall in recession periods and rise in time of prosperity during the international business cycle. But the net long-run result has been an increase in the price of manufactured products of the developed countries relative to the price of primary commodities of the less-developed nations. This means that the less-developed countries are able to purchase fewer and fewer capital goods from a given quantity of primary-commodity exports. If this decline in purchasing power had not occurred, then economic development would have spread from the export sector throughout the remainder of the less-developed economies.

Less-developed countries may be exploited by trading with international monopolies. Looking at Table I, it is very conceivable that France received much higher dollar returns for her exports than the three less-developed countries. It is also noticeable that Algeria and Tunisia receive higher dollar returns for their exports than Iraq. As it is known, Iraq is the largest date producer in the world. It seems that France maintains a more favorable terms-of-trade than these three less-developed countries. The fact that a country can maintain a better terms-of-trade indicates that she is in possession of a stronger political and economic bargaining power.

Table I
Dates Exports

Country	Quantity (Metrictons)			Value (1000 U.S. Dollars)		
	1964	1966	1968	1964	1966	1968
France	9932	9401	9241	6560	6456	7172
Iraq	282684	290873	254795	17220	18105	18028
Algeria	27900	25765	26000	9516	9310	9400
Tunisia	5092	4907	2595	1755	1774	1143

Source: Food and Agriculture Organization of the United Nations, Trade Yearbook, Vol. 23, 1969, Table 49, P. 191.

It seems that there are two viewpoints regarding the contributions of international trade as an engine to generate economic growth within less-developed countries. One approach stresses the fact that the less-developed country will benefit from specializing in the allocation of its resources to the production of goods according to their comparative advantages. The emphasis is given to the development of one sector such as the use of the export sector as a leading sector. This sector will develop and generate economic growth for the rest of the national economy.

In the second viewpoint, trade does not contribute to the generation of economic growth of the less-developed countries. These countries have been exploited by monopolistic enterprises of the developed countries. They are specializing in exporting resources and foodstuffs for which prices have been declining over a period of time, while they import industrial products from the developed countries whose prices have been rising over the same time period.

In this analysis of the effect of international trade on the economic development of a country, I am assuming that trade is the only variable which generates economic growth. The social and political institutions within the country are held to be constant. Trade can bring development when some, if not all, of these institutions are defined as variables in the growth equation given into consideration that fair international trade prices do exist for both raw, as well as finished products.

Trade Within Less-developed Countries

Jan Pen claims that the comparative cost theory is not applicable to the explanation of trade behavior between developed countries. In the industrial developed societies, the pattern of economic life is dominated by manufacturing (some 40 percent of the gross national product) and by various kinds of services such as transportation and travel, and most important, by the (knowledge) industry, such as school, the press, radio and television. The agricultural share in total production is below 10 percent. Thus, in these sectors comparative advantage is not an important fact of nature.5/

The bulk of the population in less-developed economies is engaged directly or indirectly in agriculture. This has been estimated to involve between 60 and 80 percent of the population of a given country. As in the case of the Middle East, about two-thirds of its population derive their livelihood from agricultural pursuits. The agricultural sector contributes nearly 20 percent of the gross national product. In the less-developed economies, the pattern of life is obviously not dominated by manufacturing and services. In the Middle East, the petroleum industry is dominant in supplying revenues for government expenditures with some light and semi-heavy industry. If these are the conditions of the less-developed economies, then the comparative advantage should be more important in these economies than in the developed economies. But the present conditions of the less-developed economies are characterized by market imperfections which hinder the application of the comparative-cost analysis to explain the pattern of trade within these economies.

S. B. Linder points out that trade among less-developed countries would enable them to achieve a superior allocation of resources, depending upon the amount of operation imports coming from developed countries. It would also bring the additional benefits of economies of scale and increased competition, all in accordance with the classical theory.6/ But it seems that Linder, in his analysis, assumes implicitly that imperfect market conditions do not exist, and that there are no limitations of political and social institutions in less-developed economies. Also trade between two less-developed countries cannot be maintained if both of them produce the same abundance of certain raw products such as oil, gold or copper.

Trade among less-developed countries will help them but not totally, to depend upon their own production without imports from developed countries. A. J. Meyer points out that international trade among the Middle East countries amounts to about 15 percent of their total trade; while trade with the Western countries amounts to about 66 percent of their total trade.7/ But Linder believes that trade among less-developed countries is likely to reduce the need for imports from developed coun-

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5/ Jan Pen, A Primer on International Trade, (New York: Random House, Inc., 1967), PP. 28-29.

6/ Staffan Burenstam Linder, Trade and Trade Policy for Development, (New York: Frederick A. Praeger, Publishers, 1967), P. 73.

7/ A. J. Meyer, Middle Eastern Capitalism, (Cambridge, Massachusetts: Harvard University Press, 1959), P. 12.

tries. This is due to the fact that various primary products can be secured from countries other than the developed countries.[8] The question may be raised as to whether less-developed countries will be able to live with their own production without importing products from the developed countries. The answer obviously, is no. These countries are not at the stage of economic development where they can produce all that they need. Even the present highly developed countries do import some raw materials, semi-products, and finished commodities. This is because the products are not available domestically, or the production of them is not economically feasible.

In conclusion, international trade and economic development may be integrated. This correlation, in turn, may be based on a comparative cost principle, if and only if, a perfect international trade market is assumed. But, as we all know, this is not the case and there exist political and economic limitations that make the international market non-competitive.

A perfect competitive aspect of international trade, throughout history, never had been put into practice. In recent years several attempts have been made either on a multi-lateral or unilateral agreement between different countries to try to lessen some of the restrictions that are imposed on the movement of goods between some countries. But this has always resulted in minimal success. A recent example is the Kennedy Round of Negotiations in 1963-67 between the U.S. and the five members of the European Economic Community (EEC). The objective of the U.S. team was to negotiate a multi-lateral lowering of trade barriers and to undertake a very simple approach to tariff reduction. The U.S. plan provided that almost all tariffs be cut in half. The EEC plan, on the other hand, would have resulted in an average reduction of only 10 to 12 percent.

The result of the Kennedy Round was less impressive, due to the fact that commercial markets remained unresolved. Only substantial tariff reductions were made on a wide range of individual products. Negotiations in the special groups of grains, meats, and dairy products were not generally successful; only the grains group was able to reach a measure of agreement. The other example, is the recent attempt to open trade between the U.S. and U.S.S.R.

A final comment is that I feel, in talking about international trade and economic development, the international monetary side should be integrated into the analysis. This is where most of studies on international trade and economic development failed to deal with. There is not enough key currencies to meet the current growth of the international demand for goods and services.

8/ Linder, op.cit., P. 73.