Chapter 8:
Trade Policies for the Developing Nations
Developing nations’ trade

- Very dependent on the developed industrial countries as export markets and source of imports
- Exports are heavily weighted toward primary products (agricultural goods, raw materials, fuels) and labor-intensive manufactures
- Share of manufactured exports is increasing, but mainly in a small number of newly industrialized nations (such as South Korea, Hong Kong)
Developing nations and trade

Developing nations: dependence on primary products (2000)

<table>
<thead>
<tr>
<th>Country</th>
<th>Major export product</th>
<th>As % of total exports</th>
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<tbody>
<tr>
<td>Nigeria</td>
<td>Oil</td>
<td>96</td>
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<tr>
<td>Saudi Arabia</td>
<td>Oil</td>
<td>86</td>
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<tr>
<td>Venezuela</td>
<td>Oil</td>
<td>86</td>
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<tr>
<td>Burundi</td>
<td>Coffee</td>
<td>79</td>
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<tr>
<td>Mauritania</td>
<td>Iron ore</td>
<td>56</td>
</tr>
<tr>
<td>Zambia</td>
<td>Copper</td>
<td>56</td>
</tr>
<tr>
<td>Ethiopia</td>
<td>Coffee</td>
<td>54</td>
</tr>
<tr>
<td>Chad</td>
<td>Cotton</td>
<td>40</td>
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Developing nations’ concerns

- Question whether gains from trade with industrial countries have been fairly distributed
- Face problems of unstable export markets
  - Concentration on one or a few primary-product exports combined with inelastic supply and demand conditions
- Argue that they face worsening terms of trade as relative value of primary products has fallen compared to manufactured goods they import
- Face limited market access for exports because of protectionism
  - Especially for agricultural and labor-intensive goods
Developing nations and trade

Export price instability for a developing nation
Remedies for developing nation problems

- Stabilizing commodity prices - international commodity agreements
  - Production and export controls
  - Buffer stocks
  - Multilateral contracts
- Generalized system of preferences (GSP)
- But experience with commodity agreements has been mixed, at best, and application of the GSP is spotty
Developing nations and trade

Production and export controls
Buffer stocks: price ceiling and price support

Developing nations and trade
Developing nations and trade

Cartels

- Attempt to restrict competition among producers and support higher prices for their product
- Face obstacles:
  - Incentive to cheat
  - Number of sellers
  - Cost and demand differences
  - Potential competition
  - Economic downturns
  - Substitute goods
Developing nations and trade

Growth strategies

❖ Import substitution
  ▪ Trade barriers protect emerging domestic industries
  ▪ Popular in 1950s and 1960s

❖ Export-led growth
  ▪ Focus on export of manufactures as engine of growth
  ▪ Became more common starting in 1970s
Import substitution: pros

- Risk of establishing home import-replacing industry is low because home market already exists
- Easier for developing nations to protect their own markets than to force industrial nations to open theirs
- Gives foreign firms an incentive to locate production in developing country, providing jobs
Import substitution: cons

- Trade restrictions shelter home industry from competition, giving no incentive for efficiency
- Small size of most developing country markets makes it difficult to benefit from economies of scale
- Protection of import-competing industries draws resources away from all other sectors, including potential exporters
Export-led growth: pros

- Encourages industries in which developing countries are likely to have a comparative advantage - such as labor-intensive manufactures
- Export markets allow domestic producers to utilize economies of scale
- Low level of trade restrictions forces domestic firms to remain competitive
Main disadvantage to export-led growth is that it depends on the ability and willingness of industrial nations to absorb large quantities of manufactures from developing countries.

In other words, it is sensitive to economic cycles and protectionist pressures in the export markets.
Growth strategies


Avg. annual % growth of real GDP

- Strongly outward-oriented
- Moderately outward-oriented
- Moderately inward-oriented
- Strongly inward-oriented

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Growth strategies

Growth strategies: case studies

- Brazil - import substitution in computers
  - Policy backfired, and was abandoned by 1991

- East Asian newly industrialized countries - export-led growth
  - Generally very successful, until 1997 crisis
  - High rates of investment and building human capital
  - Problems overlooked: pollution, income distribution
  - Vulnerable to protectionist reactions elsewhere
Growth strategies: case studies

- China - transformation from extreme import-substitution to focus on exports
  - Dramatic change in China’s role in the world economy has accompanied rapid growth in its domestic economy
  - Heavy state role in economy (legacy of central planning) raises issues of fairness
  - Political issues, lack of enforcement of some agreements (intellectual property) complicate economic relations
  - Accession to the WTO will mean adherence to global trade rules - and coping with the dislocations that will involve