What Role Does Trade Play in Development?

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This essay will try to demonstrate that trade plays a positive role in development. This has been more or less the standard opinion since the nineteenth century, when the famous British economist Alfred Marshall thought that trade was a major cause of progress (Hogendorn 1996). European development theory considers trade to be "the engine of growth" as D. Robertson said, and that it is the means by which the 'less developed economies' could become developed. This concept has become part of the prevailing liberal world view that (free) trade is "the generator of world prosperity, particularly when goods and services are exchanged on the basis of the comparative advantage" (Dickson 1997, 101). On the other hand, the dependency theory, views trade as detrimental to development, while incorporation into world markets would only lead to more underdevelopment. Even if the latter theory might be true, I will try to prove that it has many faults and that trade has a positive influence on development. It is mandatory to notice that the main question refers to two things – trade and development. For the purpose of making this essay as clear as possible I will first analyse the latter component of the question, and then I will focus my attention on the issue of trade. After creating the necessary background for this essay, I will look at the importance of international trade organizations in development problems and then compare the two defining theories about trade – the comparative advantage and the dependency theory. My opinion regarding the role of trade in development will become clear with the help of the authors cited in this essay such as: J. S. Hogendorn, J. A. Scholte, R. Peet and others.

Development is a much contested concept and it is clear that there is no easy or satisfying definition. What development actually does is to fuse modern advances in science, technology, democracy values, ethics and social organization, into a single human project of producing a far better world. In its strong sense, development means "using the productive resources of society to improve the living conditions of the poorest people" (Peet and Hartwick 1999, 1). In a weaker sense, it means more of everything for everyone in the context of a lot more for a few. Although, this latter form states that development basically means economic well-being for the elite, one can still notice glimpses of hope coming from the progressive notion of improving the material conditions for many people. Development is a complex and contradictory phenomenon, which reflects the best of human aspirations because great ideas form the foundation of power (Peet and Hartwick 1999).

Continuing on the path of the weaker sense of development, I have to underline the fact that the geography of trade is a massive spatial process of wealth transfer: trade does not make everyone equal, but instead it concentrates wealth. Even if this is a flaw of 'trade' I have to agree with R. Peet's "satellite view" of trade (Peet and Hartwick 1999, 10). He talks about a situation in which we could use satellites to record economic movements over space. This would create an image of a world which would look like a giant wealth-accumulation system, with status, power and income focused on a few hundred privileged suburbs. A proponent of the dependency theory would say that greater international trade would lead an economy to specialize in sectors with comparative disadvantage and that growth in world resources or improvements in efficiency do not necessarily speed up the rate of state growth. Similarly, opening up to trade might actually reduce long-run growth if an economy specializes in "sectors with dynamic comparative disadvantage in terms of potential productivity growth or in sectors where technological innovations or learning by doing is largely exhausted" (Kim and Lin 2009, 1212). On the other hand, the comparative advantage states that international trade increases the diffusion of knowledge and technology from: direct imports of high-tech goods, better connection with sources of innovation and foreign direct investment. These two views of trade will be analysed in more detail in another part of the essay.

Having created the main background for answering the question of this essay, I will now focus on the role of international trade organizations in development problems. The truth about international trade is that a large percentage of it takes place within regional free trade agreements and bilateral agreements, going around “the world market and the multilateral system” (Dickson 1997, 124). The past half-century has been witness to the creation of multiple regional free trade areas (FTAs), custom unions and a common market in the core of the EU. These FTAs are “regional associations of states with zero-tariffs between the member countries” (Scholte 2005, 143). Such areas have appeared or are about to appear in most of Europe, South Asia, Southern Africa and elsewhere. In Scholte’s view, global trade enhances consumer satisfaction by distributing more products to more people at lower prices. For the advocates of globalization and development, this is best achieved if the world would become a single open marketplace. The truth is that ‘free markets’ have generally directed disproportionate benefits to the already privileged and increased the marginalization of the disadvantaged, while unconstrained global markets have also tended to encourage “greater cultural destruction, ecological degradation and human rights abuses” (Scholte 2005, 40).

The previous paragraph underlines the idea that the magnitude of Neoliberalism has fallen short of what is needed to ensure prosperity for all. Many states and corporate actors have refused the ‘free market’ approach when its adoption would disadvantage them. This is best exemplified by the case of the few champions of global *laissez-faire,* who have not taken the logical step of advocating “unrestricted transworld movements of labour” (Scholte 2005, 40). In addition to this, the EU and the US have obstructed efforts to liberalize trade in agriculture, a measure that would substantially benefit many poor countries. Agriculture was also the “fault line” and the “notoriously awkward area” (Wilkinson 2004, 149) in the Cancun development round – officially the Doha Development Agenda – where the representatives of the World Trade Organization (WTO) had to relieve the deadlock plaguing the trade agenda and begin negotiations on the so-called Singapore issues. I am constrained by the size limit of this essay to limit the discussion of this paragraph to the ‘agriculture’ problem facing this organization. In the WTO, the US and the EU were very keen on not unravelling their complex agricultural subsidiary system and were against the opening of markets in this area (Wilkinson 2005). Therefore, the development of poorer countries is blocked by the Mercantilist approach of the main commercial powers regarding the agricultural issues from the WTO’s agenda (Woods 2008). The main idea of this paragraph is that trade plays a crucial role in the development of Third World countries and in their relation with the WTO.

Having looked at the role trade plays in agricultural development, I will now focus on the role it plays in labour-intensive manufactures of the poor countries. There is a fear that the net export of semi-manufactured and manufactured goods of the poor countries, to the richer countries will rise dramatically. This idea is based on the false assumption that each poor country will become a large supplier of labour-intensive manufactures, which would lead to “an avalanche of exports” (Ranis and Raut 1999, 62). International economists have long understood this case and have called it the phenomenon of “ladders of comparative advantage.” I will come back to the concept of the comparative advantage, after looking at the classical economists’ point of view. A proponent of this view was Adam Smith, who argued that trade plays a crucial role in development economics because it is the main way of exchanging products which would save time, labour and increase dexterity (Peet and Hartwick 1999). His argument for free trade is that under it, all goods would be produced where their absolute costs in terms of labour are lowest. What this means is that each country would benefit from trade, when it would specialize in the production of the good that it would produce more efficiently. This leads us to the conclusion that international trade flows reflect the fact that goods and services can sometimes be imported at lower cost from abroad than they can be produced at home (Marrewijk 2002).

In this part of essay we will look at the two opposing theories about trade – the comparative advantage and the dependency theory. Continuing on the previous paragraph’s idea, I have to underline the fact that Smith’s argument is based on the comparative advantage. This concept argues that if countries produce what they can do best and leave to other nations what they can produce with less efficiency, then real output, income and consumption will be higher than it could be in the absence of trade (Hogendorn 1996). The theory of comparative advantage dates back to David Ricardo’s book *The Principles of Political Economy and Taxation* (1817). This approach emphasizes the powerful point that gains from trade for one country are not losses for another. To make his case Ricardo used the famous example of England and Portugal exchanging wine and cloth, while Jan S. Hogendorn (1996, 435) uses the example of Poveria and Penuristan exchanging food and clothing. Here, trade is seen as a positive-sum game in which both participants gain and, therefore, both of them have a surplus of capital which would go into development. I have to highlight the fact that in order to establish gains from trade, we do not need to take into consideration the fact that labour in one country is more or less productive than labour in another country. The only thing that matters is whether a nation gains or losses from producing a good itself.

The modern explanation for the comparative approach was developed by two Swedish economists Eli Heckscher and Bertil Ohlin, who called attention to factor proportions as the most important element. Basically, the Heckscher-Ohlin idea is that nations export goods that intensively use their abundant factor and import those goods that are manufactured from the scarce factor. One conclusion of this model is that less developed countries (LDC) will probably begin exports with primary products and then move to labour-intensive manufacturing. Hogendorn (1996, 439) goes on to say that this model predicts that trade will increase the income of the most abundant factor because the exported item employs that factor intensively. One problem with this model is that it would seem to suggest that trade between the developed countries and the LDCs would be much larger in volume than trade among the developed countries themselves. The truth is that trade among the developed countries predominates because of specialization, product differentiation and increasing gains, which also explains the existence of international trade (Wilkinson 2004) and goes on the lines of the idea expressed by Richard Peet in his 'satellite' experiment.

To further develop this essay I will look at several critiques for the comparative advantage. It is commonly assumed that the South exports primary goods to the North and imports manufactures in return; while, the North exports manufactures to the South and imports primary commodities (Dickson 1997). However, when all exports are included, the LDCs' share of total world trade has mostly been falling, rather than rising. The developed countries, not the LDCs, have been doing better at expanding their trade (Williams 2005). If we would take together all these North-South arguments concerning trade, we would end up with the dependency theory as some critics of trade call it. The name actually implies the 'locking' of LDCs into an inferior and worsening trading relationship with the industrialized countries. This is why many economists believe that the main advantage of trade in development economics is not its static gains, as in the Ricardian model, but in the dynamic advantage of changing factor proportions and hence changing comparative advantage (Hogendorn 1996). I have to underline the fact that there is still no guarantee that dynamic gains must accompany trade. Coming back to the dependency theory, I will talk about its three component theories. The first one is called the unequal exchange argument and its main advocate is Arghiri Emmanuel, who argued that international trade made poor countries poorer and rich countries richer (Peet and Hartwick 1999). Arghiri uses capital movements to make his point that a poor country has to exchange more of its now cheaper goods for less of the rich country's output. This puts LDCs in a worse off position than they would have been without trade. A powerful attack on Emmanuel's position was mounted by Paul Samuelson, who states that this analysis assumes no change along the production possibilities curve after the opening of trade. What this actually means is that a move towards specialization would alter Emmanuel's way of thought (Nakagawa 2006).

Having finished with the first component of the dependency theory, we can move on to the second one – the enclave argument. This is a major criticism of trade as an expediter of growth, often associated with the Swedish economist Gunnar Myrdal and it concerns the linkages and multiplier effects between the trading activity and the domestic economy. It is also called the 'backwash argument' and its proponents often agree that trade along the lines of static comparative advantage may indeed be of benefit to all, but that some countries will benefit more than others. A very good counter-example for this would be Sri Lanka's tea industry, which represents an enclave economy where exports provided little "domestic stimulus" (Hogendorn 1996, 447). In this situation, I have to stress the fact that there are other reasons for the existence of enclaves such as: masses of unskilled labour available for employment at low wages, financial and political institutions, the political process and the tax system. Therefore, it would seem far more reasonable to attack the enclave effects of international trade with a combination of taxes and development programs than to attack the concept of international trade itself.

This brings us to the third and final argument – the terms of trade argument – which is actually a shorthand way of expressing a general pessimism on the prospects for exports from the LDCs, especially when these exports are primary products. The main advocates of this argument are Raul Prebisch and Hans Singer, who argue that the prices of primary products exports have declined in relation to the prices of the goods exported by the industrialized world. There is a secular tendency for the ‘terms of trade’ to turn against the exports, especially those of the primary products of the less developed countries (Nakagawa 2006). It is generally agreed that yearly or cyclical price changes, even when severe and disruptive, are not evidence of a long-run decline and can be due to very different causes such as: a weak demand for primary goods, the demand for food and a weak demand for natural raw materials. There is a plausible argument that long-run adverse shifts in the terms of trade might be experienced by LDCs, but the debate between scholars goes on (Hogendorn 1996).

In this essay I have argued that trade has been an expediter of long-run growth for the South and, at the same time, for the North. Therefore, I have to agree with Jan S. Hogendorn’s (1996, 463) idea that trade will probably remain “a good bet for the future”. We should also take into consideration the fact that there is no magic through which even successful trade will automatically solve the many problems of countries today and ensure global development. Although, trade has come under a lot of scrutiny and attacks, the truth is that the result without trade may be far less favourable: a stagnant idleness of the factors of production due to a very limited local market. For a lot of countries, exporting crops, mining or production of some manufactures for export, even when their linkages and gains are low, may be the only plausible way to start the development process. The best way of proving this point is to try to think of the even worse poverty that would be found in Senegal without its peanuts; Uganda without coffee; Sudan without cotton; Zambia, Peru and Bolivia without copper or tin (Marrewijk 2002). In sum, many developing countries were pessimistic about trade because of the dependency theory. The response by political leaders in these countries was the adoption of an “inward-looking” or “inward-oriented” strategy that was pessimistic concerning exports and designed to substitute imports with domestic production. Many people, especially non-economists, supported the general idea of self-sufficiency, or “autarky” as it is sometimes called. However, experience showed that there were too many penalties to be paid with such a policy and, therefore, almost everyone turned back to the idea of trade being “the engine of growth” (Dickson 1997, 101).

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