CHAPTER I

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The advanced countries of the world still adhere to and their national economic policies and very considerably influenced by their experiences in regard to the crucial role played by 19th century world trade in promoting the economic development of "new" countries. But the empirical studies have now made it obvious that the 19th century trade which has been considered as an "engine of growth" was the product of certain peculiar circumstances prevailing at that time and the trade between the "centre" and the "peripheral" areas, in those days, was being expanded on account of them. These days, the newly emerging doctrines which are determining the trade relations between the high and low income countries must be realised in order to make the international trade relevant to the rapidly changing real world and the requirements of primary producing countries. Concentrating on this point as a decisive force an attempt will be made here to trace the significance of trade in the development of world economies particularly in the development of underdeveloped countries like India.

The classical trade theorists took the growth of world economies for granted. They concentrated mainly on engaging the attention of the countries in the specialization of those products in which they possessed comparable advantages and advocated relying upon the self-operating monetary mechanism for eliminating the fluctuations which take place in order to make the external demand conditions unfavourable. According to the assumptions of the economists, this results when the two countries, previously isolated, come to an agreement for making the optimum use of their resources by re-allocating for increased specialization. International trade was helping the development not only of the peripheral countries but also the leading dynamic centre. For instance, in England at the time of Ricardo when the margin of cultivation was being extended to the hill sides into poorer and poorer land, the struggle for food would have retarded the pace of industrialisation going on in Britain and in some parts of the western Europe.

But the 19th century world trade which played a vital role as an economic activator was not merely the result of the optimum allocation of given resources on the lines of comparative advantages. In that process, there existed something more which was inherent in it and working for transmitting the process of economic growth from the advanced centre to the

new countries of the world and it enabled the underdeveloped countries to make improvements in their existing resources. This exceedingly significant aspect of the 19th century experience of world trade which accelerated the pace of the development of underdeveloped countries was by and large ignored by the classical trade theorists. Trade was an engine of growth transmission as well as a means of improved allocation of existing resources. The classical trade theory derived a great deal of prestige from the brilliant record of 19th century trade and development, even though it paid little or no attention to an essential aspect of that experience, namely, the dynamic spread of economic growth through trade.

In 19th century world trade was being dominated by Britain which accounted for one-fourth of the world trade in 1860. Between 1815 and 1814 the population of Britain, inspite of large immigration, increased only by about three times, but the increase in its real income and the volume of

2. There was however an exception in Adam Smith whose "vent for surplus" whose theory of international trade emphasised this aspect.
3. Ibid.
imports was nearly ten and twenty times respectively.\(^1\) Moreover, while the ratio of imports to the national income was merely 12% in the beginning of the 19th century, it increased by about 30% in its latter part.\(^2\) The historical accident of the Industrial Revolution also occurred in Britain before it did in other countries of the world\(^3\) and as the British economy had limited resources and synthetic production was also unknown, it had "to grow outwards" and there emerged the true pattern of the classical exchange of manufacturing goods for food stuffs and raw-materials of less developed countries.\(^4\) The industrialization in Britain facilitated the transmission of growth from the British economy to the countries of temperate regions through the enormous and steady increase in Britain's demand for primary products in which they enjoyed comparative advantages and were thus well-endowed for their production. A number of local factors induced by trade in these countries were absorbed on account of the expansion of profitable production of the primary commodities for export, and the increasing earnings from exports were

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1. Ibid., p. 14.
4. Ibid.
used for financing the essential imports of capital goods\(^1\) which created the base for industrial development in the new countries of the world.

The increasing British demand for the primary products of underdeveloped countries did not only encourage the production of these commodities but also induced the outflow of capital and skilled labour from Britain to the underdeveloped countries.\(^2\) The traditional pattern of "growth through trade" is most easily discernible in the interaction of 19th century British development with that of the "Regions of recent settlement"\(^3\) The countries of this group similar in nature, yielded a large success to attain a high rate of growth through the exports of primary products which were being demanded in large quantity by Britain and the private foreign investments induced in these countries by the prospects of earning relatively high profits by trade.

The British demand for primary products was mainly confined to the new countries and most of the British capital invested abroad went to them. For instance, the share of

\[\text{Reference citations}\]


3. Hilgerdt, Folk, who termed the peripheral countries as the "regions of recent settlement" included in it Canada, Argentina, Uruguay, South Africa, Australia and New Zealand. He excluded United States from this group of countries as he considered it a big trader and producer itself and it was helping the growth of the less developed countries in the same way as the Britain. Nurkse has, however, emphasised that U.S. also substantially belonged to the group of new countries, cf. Nurkse, R, p.15.
these countries in British imports was only about 8 per cent in the middle but it increased to some 18 per cent at the end of the 19th century. Consequently, a substantial amount of British capital flowed into these countries. If, the year 1870 is taken as determining the geographical distribution of British capital invested abroad, we find that the share of the countries of temperate latitude increased rapidly from about 10 per cent in 1870 to nearly 45 per cent in 1913. It is important to note that these figures do not include the trade with and the exports of British capital to the United States whose share in British imports of primary products as well as the exports of British capital had been constant during this period. However, there was a very considerable increase, in the early years of 19th century, in the trade and the outflow of British foreign private capital to the

1. Nurkse with the assistance of Dr. Robert M. Stern prepared the percentage distribution of British imports by countries of origin which can be understood from the following table:

<table>
<thead>
<tr>
<th>Country Type</th>
<th>1857-59</th>
<th>1911-13</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>19</td>
<td>19</td>
</tr>
<tr>
<td>Other 'new' countries (a)</td>
<td>8</td>
<td>18</td>
</tr>
<tr>
<td>Industrial Europe (b)</td>
<td>21</td>
<td>23</td>
</tr>
<tr>
<td>All other areas</td>
<td>52</td>
<td>40</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

(a) Canada, Argentina, South Africa, Australia, New Zealand.
(b) Germany, France, Italy, Belgium, Netherlands.

Source: Nurkse, R. op. cit., p. 16.

2. The total amount of British capital invested abroad increased from some £1,000 million in 1870 to about £4,000 million in 1913. The percentage distribution in the different parts of the world may roughly be indicated as follows:

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United States for which no reliable statistical data is available.

Thus, the inducement for the outflow of British capital to the primary producing countries was in response to British demand for the primary products. The new countries were given special favour by the flow of capital as well as the rise in demand for their exports of crude products. This phenomenon was inter-linked and private foreign investment was more or less induced by the growth in demand for essential foodstuffs and raw materials. But it is interesting to note that this inter-dependent phenomenon was not closely related with regard to timing. For instance, in 1880's there happened to be a large flow of British capital while the trade in primary goods was depressed. It, as a matter of fact, was carried on in expectation of long run expansion of demand in the industrial centres for the raw materials whose supply was being increased continuously. ¹

The economic growth thus achieved was essentially cumulative in nature on account of the close relationship

<table>
<thead>
<tr>
<th>Cont.</th>
<th>1870</th>
<th>1913</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>20</td>
<td>20</td>
</tr>
<tr>
<td>Other &quot;new&quot; countries</td>
<td>10</td>
<td>30</td>
</tr>
<tr>
<td>Europe</td>
<td>50</td>
<td>50</td>
</tr>
<tr>
<td>All other areas</td>
<td>20</td>
<td>30</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>


¹ Ibid.
between the increasing demand for the primary products of the new countries and the resultant foreign investment in them. In those areas where natural resources were abundantly available, British capital was attracted in large amounts and was efficiently utilized for augmenting the exportable surplus. The demand for exports alone is of crucial importance and is a favourable factor for improving the terms of trade. Even if it does not help to make the terms of trade favourable, it serves the purpose indirectly. It earns a variety of goods in exchange and facilitates the production by bringing capital and labour in line where these economies possess comparative advantages. Moreover, the inflow of foreign capital into the peripheral countries, which was in response to the vigorous demand for the primary products, played a vital role not only in increasing the exports but also in helping in building up the "infra-structure" which was essential to the expansion of domestic activities. Attention was, in particular, being paid to the Railways in order to make transport easier and cheaper.

But, so far as the economic growth of now advanced countries is concerned, the trade and investment relationship was not the main factor responsible for their rapid economic growth; there existed a number of locally available favourable factors which helped the phenomenal growth of their economies.


These countries did not pass through feudalism partly because of social relations in 18th century England but mainly because no indigenous manpower was available for the settlers to exploit.\(^1\) In economies like the United States, Canada, Sweden and Japan the pre-conditions for accelerating the rate of growth had already been established. Foreign investment and rapidly increasing exports were then able to play a significant role in supporting what Professor Rostow has called the "take-off" into sustained growth.\(^2\)

Marshall and Robertson termed all the old countries (in Europe) and the new countries (over seas) as the World's "Industrial Workshop" and the "granaries" respectively. But they ignored "the exotic countries, the 'outsiders' namely India, China, Tropical Africa and Central America\(^3\) which were untouched by both the expansion of export demand as well as the flow of foreign investment.\(^4\) In these countries, which have now become the "problem" countries in development economies, trade and capital were both active in certain sectors of their economies resulting in a "dual economy", that is to say that there existed a fully developed export sector mainly serving the interest of the metropolitan states\(^5\) along with a primitive

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1. See Ignacy, Sachs, "Foreign Trade and Economic Development of Underdeveloped Countries" New Delhi, 1965, p. 29. See also Celso Furtado, "Uma Economica Dependente", Rio de Janeiro, 1956. He rightly pointed out that the main difference between the economic development of Brazil and that of Australia at the end of 19th century was that Brazil had a sizeable reserve in indigenous labour force in the pre-capitalistic sector and therefore there was no incentive towards increasing the labour productivity in agriculture sector. K. B. H. remarks that whereas in the countries of low wages the expansion of exports continues keeping the enclaves in existence, in the countries with high wages, the export expansion leads to industrial development. See his "International Trade and the Rate of Economic Growth", EHR, No. 31960, pp. 355-56.
domestic economy. The economic development through trade and investment was of a completely lopsided character due to the unfavourable socio-economic conditions prevailing in these countries. It should therefore be obvious that trade and investment do not promote the economic growth of the country if the domestic resources are inadequate and the socio-economic conditions are not favourable. Inadequate savings and lack of an efficient and diversified structure are the salient features of these economies which, in turn, "minimize the incentives for economic change, weakness entrepreneurial motivation and limit labour mobility".


Thus, British capital ignored the tropical countries and was mainly directed to the temperate regions which have been the main granaries of the world and are now industrially advanced. They enabled Britain to undertake her huge programme of industrialization by making available raw materials and food, and thus removed the food crisis that was the worry of Malthus. Indeed, it was the main object and achievement of British capital export.

It seems surprising to note that in spite of an enormous expansion in world production in 20th century, trade has grown at considerably by lower rate. For example, during the period 1928 to 1958, the volume of world trade increased by 57 per cent whereas the expansion in international trade during the period 1880 to 1913 and 1850 to 1880 was 170 per cent and 270 per cent respectively. This slackening in world trade may partly be attributed to the rapid growth of production in a country like the United States whose relative weight in world production is greater than in trade. Even if the United States had maintained its own relatively low import ratio to national product, the phenomenal rise in the U.S. share in world output would have reduced the average ratio of world trade to world production. In fact, America's own import ratio declined and it further contributed to the already existing wide lacuna

1. It excludes Soviet bloc.

in world trade to the world production.\textsuperscript{1} For the widening uneven ratio of international trade to world production, partly the commercial policy but mainly the changes in the internal proportion of world trade are responsible. Before 1914, the export of primary goods expanded more rapidly than the export of manufacturing products in spite of enormous increase in their production. In the mid-20th century we find that exports of food and raw materials are lagging far behind the export of manufacturing products. There exists a steadily widening gap between the exports of developing countries and their import requirements and debt servicing charges.\textsuperscript{2} Although world trade expanded from 6.4 per cent during the second half of the 1950's to 8 per cent between 1960 and 1966\textsuperscript{3} - the share of underdeveloped countries in international trade steadily declined from 31.2 per cent in 1950 to 19.1 per cent in 1966.\textsuperscript{4} However, the true picture is obtained, if the petroleum producing countries are excluded as they are enjoying a petroleum boom in 20th century. Excluding the oil exports, the decline over the same period was from 24.4 per cent to a little over 14 per cent.\textsuperscript{5} On the other hand the share of advanced market economies in world trade increased from 461 per cent in 1950 to 70 per cent in 1966.

\textsuperscript{1} Nurkse, R.p.20.
\textsuperscript{2} See I.I.F.T.\textsuperscript{\textregistered}UNCTAD-II, A step Forward; New Delhi, 1968, p.7.
\textsuperscript{3} Ibid.
\textsuperscript{4} Ibid., p. 7
\textsuperscript{5} Ibid.
and about 52 per cent of world trade in 1966 was among the developed market economies which was equal to nearly three fourth of their total trade.\(^1\) In contrast to the intra-trade among the developing countries in 1966 declined to about 3 per cent, accounting for only 16 per cent of the total trade of the group as a whole.\(^2\)

The adverse movements in the terms of trade of developing countries have aggravated the problems arising out of the slowly expanding exports of these countries. We find that "most of the underdeveloped countries are saddled with a basket of traditional export goods ... the prices of which have been lagging behind".\(^3\) Myrdal explaining the reasons for "too low" a price for the primary products of underdeveloped countries, has supported the Prebisch-Singer thesis that the terms of trade between the developed and underdeveloped countries have always moved against the primary producing countries. The monopolistic elements in their product and factor markets enabled the advanced countries to keep the benefit of their technological progress in the form of increasing income of the factors of production; in underdeveloped countries the increase in productivity have always been distributed in price reductions.\(^4\) Recently, the loss

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1. Ibid.
2. Ibid.
incurred by the underdeveloped countries owing to the unfavourable terms of trade has been nearly $2.2 billion which is equal to one-fifth of the annual net flow of capital into these countries from all sources in the years 1961-65. Moreover, the total outflow of capital from the developed market economies as a percentage of their gross national product declined from 0.87 per cent in 1961 to an estimated 0.63 per cent in 1966.

As is obvious from these figures, the trading between the developed market economies and primary producing countries is quite unbalanced. The advanced countries of the world are the best customers for each other. The major part of the export of non-industrial countries goes to the matured economies. They have little trade with each other as a result of their low purchasing power and low productivity. In sharp contrast, the exports of the advanced countries to each other are far greater than their exports to developing countries. Thus, the primary producing countries are facing a steadily widening gap in their export earnings over import requirements and, therefore, certain necessary remedial measures have to be evolved in order to promote their export along with their basic objective of economic growth.

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Now the advanced economies are, unequivocally, making rapid progress but the growth is not being transmitted through increasing their demand for the primary products of underdeveloped countries at an adequate rate. The failure of 20th century world trade to promote the economic development of these countries is attributable to some identifiable social and technological changes;¹ (a) the composition of industrial production in the advanced countries has changed in favour of more complex goods such as engineering and chemicals which require relatively small amounts of raw materials supplied by primary producing countries; (b) the income elasticity of demand for many of the primary products is low. With the rise in income in the advanced countries the consumption pattern has shifted towards the goods produced with lower import content;² (c) agricultural productivity has steadily increased and largely affected the import of primary products; (d) large economies have been achieved in the industrial uses of natural

1. See Khan, M.S. "India's Economic Development and International Economic Relations," New Delhi, 1966, p. 39; See also New Directions for World Trade, op. cit., p. 213.

2. Ibid., Nurnse, is right when he says that, "There is no doubt that the opening up of trade can bring very sizeable gains to a primitive economy, but is there any guarantee that trade alone there after cause a rate of growth that can be regarded as satisfactory in the light, for instance, of population increase at home or the living levels prevailing abroad? There is no such guarantee, especially if the export products which the comparative-advantage principle forces a country to produce face an external demand which (a) is generally inelastic with respect to price; and (b) what may be more important shows only a sluggish rate of increase in total volume. Granted all the advantages of international specialisation, there remains a possibility of dead lock and comparative stagnation" See his "Equilibrium and Growth in World Economy", Cambridge, Mass, 1961, p. 253.
resources; and (e) they have succeeded in reducing more and more content of primary products required by introducing synthetic and other man-made substitutes. These developments in the advanced countries have limited the opportunity of less developed countries to export labour-embodying products in competition with the similar goods produced in advanced countries by capital intensive techniques. The assumption that the production of the goods, depends upon certain specific combination of inputs, has been found untrue. For instance, rice which is produced in Burma with labour intensive techniques will have to compete with the rice produced in the United States with capital intensive techniques.\(^1\) The main problem arises when the developed countries start producing substitute goods. The nylon-rope which is being produced in the advanced countries with capital intensive techniques has replaced the manila rope in its all uses since the latter is produced with labour intensive techniques.\(^2\)

The underdeveloped countries have suffered a tremendous loss in their export share in relation to the output and income of the industrial world. For example, the export of the primary producing countries since the 1920's to the United States of America and Western Europe declined from 3.5\(^\%\) per cent to less

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2. Ibid.
than 3 per cent. Moreover, again, if the oil producing countries are left out of account the decline in their export is higher i.e., it diminished to 2.5 per cent. For the United States alone, the ratio of imports to gross national product reduced from about 5.7 per cent in the period 1896-1914 to 2.97 per cent in 1955. Again against this there was enormous expansion in the 19th century British imports of crude products from the peripheral countries. Professor Schultz rightly pointed out that the demand for the import of primary products has remained far behind the growth of the American economy. However, it is a natural tendency in industrially advanced countries which make a huge investment in research and development that the growth of synthetic substitutes and a series of innovations taking place diminishes the content of imported raw materials needed for the production of manufactured goods. Similar tendencies are working in Western Europe.

3. He says that "We explain the slow increase in consumption of primary products in the United States in terms of the income elasticity of demand. Put in its simplest terms, the demand scheduled has shifted to the right at a rate which has exceeded only a little the growth of population. A mere than doubling of per capita real income has added only about one-sixth to the demand for primary products... on the supply side, we infer that enough additional output has been forthcoming to satisfy the increase in demand at about the same...(relative) supply price except in the case of forest products." See his paper on "Economic Prospects of Primary Products," presented under the auspices of the International Economic Association, Rio de Janeiro, August, 1957.
The slackening of exports from the underdeveloped countries has been attributed to factors working on the demand as well as on the supply side. Nurkse pointed out that the wide gulf existing between the developed-market economies and the underdeveloped countries is mainly due to the sluggish expansion in external demand for the primary products of these countries.¹ Cairncross suggests that the growth of primary products in the 19th century was not simply the result of rapidly expanding demand from the British economy; it mainly originated from the internal resources available in those countries and they were able to offer large savings to their European trading partners in order to deter them from the production of primary goods. Therefore, if the internal organisation is disrupted and enough capital is not available the underdeveloped countries are frequently discouraged from making optimum use of their abundant resources and the supply is limited.² But this was true only in the case of the new countries which were well endowed with all necessary complementary resources and are now industrially advanced. The exports of primary producing countries like India and Indonesia with high population, low capital and low productivity are adversely affected when they redirect their resources to subsistence production for local needs.³ Further, the internal limiting factors were reactions

to the relatively unfavourable demand conditions for primary products and served protecting the terms of trade of the underdeveloped countries as the demand for the primary products was not merely expanding slowly but also "to be price-inelastic in the lower ranges of demand schedule".  

The factors, stated above, which illustrate the persistent sluggishness in the expansion of 20th century external demand for the primary products of underdeveloped countries explicitly signify the unbalanced pattern of international trade between countries at different stages of economic growth. A wide gap is existing between the developed-market economies and the underdeveloped countries of the world and the gap continues to grow wider in spite of a large amount of capital transfer in the form of loans and grants to and an increasing volume of exports in absolute terms from the underdeveloped countries. Obviously, the success of the process of economic growth necessitates an overall internal transformation of the country. But in view of the paucity of necessary resources in these countries and their weaker position in trading relations, they are not benefited to the required extent. The 19th century pattern of growth through trade was altogether different and it played a significant role in transmitting growth from the British economy to the group of recently settled and predominantly rich countries; many of them are now industrialised or well on the way to industrialization. This took place


2. The volume of exports from the less developed countries during the period 1928 to 1956 increased by about 25 per cent. See G.AIF.T. Index 1956, (1928=100).
through the vigorous expansion in British demand for the primary products of these countries. Moreover, the trade was extremely helpful in the sense that it provided (a) comparatively advantageous employment to any increases accruing in the domestic labour force and capital stock; (b) opportunities attracting idle resources into the productive activities required for the purpose of exports; and (c) adequate inducement for the inflow of foreign private capital to these countries. All these favourable tendencies led to a large expansion in capital and improvement in the techniques of production which accelerated the rate of their economic growth and constitute a pattern of "growth through Trade". This was the peculiar feature of 19th century international trade between the centre and the outlying areas.

The economic atmosphere of international trade has changed in the 20th century\(^1\) and the "mechanism of growth transmission is now in comparatively low gears\(^2\)." The continuously existing lag in the export of primary products of the less developed countries offers an adequate explanation for the discouragement of foreign private capital in those countries\(^3\). In such circumstances, when

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2. Nurkse, R. p. 27.
3. The oil producing non-industrial countries are excluded from this group as the petroleum-boom product of 20th century, has enjoyed a large expansion in the world demand and induced enormous investment of foreign private capital mainly from United States. Though, these countries bear certain common features with those of new countries of 19th century but in view of basic differences in their internal structure, the temperate regions are still more important and interesting illustrations of trade and development relations.
most of the productive activities of the world are concentrated in a few advanced countries, the idea of "symmetry, reciprocity and mutual dependence" appears to be inapplicable so far as the trade between the high and low income countries is concerned. ¹

The problem arises of making use of an increasing capital and labour force and as no useful results are expected from the application of these increasing productive resources in the primitive sector, it becomes indispensable to evolve suitable measures which would ensure that the maximum benefit from trade goes to the underdeveloped countries and that certain new patterns and openings of trade are established in order to promote the growth of primary producing countries.

The most appropriate alternative for the solution of the growth problems of underdeveloped countries is the diversification and industrialization of their economies, taking into consideration the rate at which their productive resources increases. ²

Enough capital formation will be created out of the process of economic development and would adequately absorb the increasing resources. The underdeveloped countries do enjoy certain "established" comparative advantages in the production of primary

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¹ It does not mean that the growth through trade is merely attributable to the 19th century. It still to play a vital role in the transformation of the economies of less developed countries. But as the demand of advanced countries for the primary products, with the exception of petroleum, is relatively lagging far behind, it diminishes the importance of growth through trade and does not offer attractive opportunities for expansion in underdeveloped countries.

products and therefore the programme of industrialization neither necessitates any abandonment nor any contraction in the export of these goods. It rather favour an increase in their export to the extent that their external demand rises. The problem in these countries is due to low "incremental" comparative advantage and an optimum allocation of the rising productive resources is a central problem of dynamic trade theory.

As such, the primary producing countries should engage in the production of manufacturing goods and start exporting them in addition to their exports of primary products. Professor W.A. Lewis is right when he says that it is an appropriate alternative solution suitable to those countries which have abundantly available cheap labour not only in relation to capital but also in relation to land. Moreover, it is "as natural and economic development that relatively poor countries with high population densities like India and Hong Kong should export cheap labour-intensive manufactures in order to import food stuff like wheat from developed countries such as Australia, Canada and the United States which are rich in land and capital".  

The underdeveloped countries have ample scope for expanding their exports of cheap manufactured goods and by making certain expenditures in research the export of light engineering and electronic goods can also be increased as they have a low capital-output ratio. The theory of factor proportion in international trade based on the pioneering work of Heckscher and Ohlin also strongly supports the view that incremental comparative advantage of densely populated countries with inadequate natural resources lies in their increased exports of simpler and cheaper manufacturing consumer's goods. They could, given favourable market conditions, displace the high cost supplier in the developed countries who would be shifting to higher and more rewarding lines of productive activities. Further, the expansion of exports of less developed countries would be in the interest of advanced countries. The underdeveloped countries lacking resources would be able to purchase capital good needed for their programme of planned economic development from industrially advanced countries. Therefore, the revenue the low income countries will be able to earn by selling their products to the advanced countries would immediately be spent on the capital goods from them. On the other hand, if the advanced

3. See New Directions for World Trade, p. 29.
countries did not provide a market for the goods which can more cheaply be produced in the underdeveloped countries, they would lose the opportunity of earning more profit by increasing their export of capital goods. "The cost of them of maintaining a high degree of self-sufficiency in sugar, textiles and the like would be a diminution in their exports of engineering goods".  

If this programme is implemented, the underdeveloped countries would be able to achieve their desired goal i.e. high rate of economic growth and consequently favourable terms of trade. However, numerous problems are faced by these countries in promoting their exports of manufacturing goods to the developed market economies. On the supply side, undoubtedly, labour supply is abundantly available and is also relatively cheap, but it is not cheaper for the purposes of industrialization when the labour force is "illiterate, unskilled and indisciplined". The theory of factor proportions was very particular in emphasizing the quality aspect of labour as a factor of production. Just as we find that in the deserted areas of the world and marshes along the Equator plenty of land is there but is of no use. In the same way, we should be cautious in making inferences regarding the relative cheapening and plentiful availability of labour in an over-populated country. It can, however, become cheaper by raising it to a "minimum level of economic efficiency". But the history of economic development of now advanced countries reveals that the

1. Ibid; p. 29.  
2. Khan, M.S. op. cit., pl11  
3. Nurkse, R. op. cit., p. 36.
creation of a labour force suitable to the production of manufactured goods required an enormous expenditure on the part of the Government in social over-heads such as education and health. Expenditure on social over-heads is usually neglected but it is important to note that the development of human capital is an indispensable condition for the successful execution of a programme of economic development.¹

Equally formidable obstacles are to be faced on the demand side arising out of the restrictive commercial policies of the advanced countries. The success of growth through industrialization for export depends upon lenient trade policies of developed countries which cannot be relied upon with certainty. Generally speaking, a number of problems are raised in the advanced countries in reaction to the imports of manufacturing goods from the low-income countries. If the existing producers in the advanced countries start insisting upon a fixed share of the market for the crude products as a protective measure of their commercial policy, then the new entrepreneurs in the underdeveloped countries will be uncertain in regard to the demand for the produce they tend to supply. And the fact that the export of simple kinds of manufacturing goods such as textiles,² can have a place in the market of advanced countries, by displacing the higher-cost producers there, will instead become a persistent source of "trouble, resistance and frustration."³ While the suppliers in

² Nurkse, R., p. 39.
³ The same.
the underdeveloped countries are merely making use of their one advantage which has been made obvious by the empirical studies of international organisations, makes them effective competition in the market of industrial countries. Stronger protests are made when the low-wage competition products are given protection by providing export subsidies as an aid to infant industry and, if, they start adopting relatively measures the scope of the protection will also be limited.¹

Although the advanced economies have some economic justification for giving protection to their domestic consumer-goods industries owing to the low mobility of labour and wasteful unemployment which are adversely affected by the low-wage competition goods imported from the underdeveloped countries,² they, now possess more comparative advantages, can purchase from cheaper sources and are able to divert their scarce man-power into higher wage and productivity. What has been found is that when it affects their immediate comforts, they feel it troublesome and do not care for affording the cost. It is unfortunate that in spite of the fact that the American economy, like the West European, is moving in the direction of more rewarding activities its trade policy has accepted the prevention of imports inimical to the internal consumer-goods industries as one of its essential tasks³ and it has retarded the rapid shift in the American industrial structure in the direction of the production of goods requiring

higher skill. If the export of primary products face price inelastic demand and the success of the exports of their manufacturing consumer-goods depends "on a high degree of internal mobility and adaptability in the older industrial countries," one of the alternative remains for them is that they should expand industrial output for domestic consumption, seek co-operation and increase the intra-trade among themselves which would near regional economic development.

Industrialization for the home market, i.e., import substitution is easier in the sense that it does not have to depend upon the policies of advanced countries because the goods are produced under the shadow of restrictive import. It would also enable these countries to escape from the "immeserizing growth", which means that the growth of productive factors would lead to stagnation if they were put to the existing export sector where these countries enjoy certain comparative advantage. This results from the unfavourable external demand conditions for primary products. But the high income elasticity of consumer's demand in underdeveloped countries, which means that the workers employed there tend to spend their income immediately on purchases of goods and services in order to fulfil their requirements, necessitates a complementary advance in agriculture. It should, however, be accompanied by internal saving of money which would otherwise have been spent on consumption goods leading to inflationary


2. See Khan, M.S. op. cit., p. 38. "We should not forget of course, conti."
pressure. In underdeveloped country, a small increase in manufacturing would require a relatively larger availability of food i.e., improvement in farming, while in the high income countries a small increase in agriculture is likely to support a greater increase in the development of manufacturing products. Therefore, the underdeveloped countries cannot afford to minimize their agriculture. Their economies have a "natural agricultural base" which also becomes important due to rapidly increasing population. Moreover, in these countries an increase in output is even necessary for making a shift to cost reducing techniques as distinct from the investment undertaken for expanding the manufacturing goods. All this takes place because of the high income elasticity of consumer's demand in the primary producing countries and as such the doctrine of "Balanced Growth" should be conceived as a means of promoting the overall economic growth of underdeveloped countries. Certain price incentives through suitable fiscal measures and some other restraints would be required for promoting increases in output that are diversified in accordance with domestic income elasticities of demand so as to provide markets for each other locally, in contrast to output expansion for export, which is specialized in accordance with international comparative advantage. They would be substituting capital goods for the import of consumer goods and thus enhance the rate of growth of their economies. It would also facilitate

...that import restriction on consumer goods cannot lead to a net increase in capital formation without an increase in saving", (cf.Kurkwa, R. p. 48, footnote).

1. Meier, G.M. op.cit., p. 84.
the creation of productive capacity, and, in course of time, the internal market would also be enlarged. After a certain profit, the underdeveloped countries would also start producing goods of more quality for export without displacing the existing enterprisers in the developed countries. The rapid economic development of the countries of temperate regions took place not largely due to the displacement of each other's existing producers it mainly resulted from rapidly expanding demand for the growing varieties of industrial products. Japan has been quoted as an example which can be copied by a number of underdeveloped countries for attaining efficiency and self-reliance in the process of their economic development. Japan has now reached such a stage of development that it has started exporting to the United States products like engineering and optical goods without facing the obstacles which came in the way of exporting textiles to the American Market. It has been found that Japan in the beginning mainly relied upon the domestic market for industrialization. The internal demand for industrial consumer goods largely increased because of remarkable progress in agricultural productivity.

If, however, the mobility of resources, particularly of increasing resources, is accepted, a different approach is

1. Norkse, R. p. 47.
possible. The balanced of payments problems are solved through worsening the terms of trade.\(^1\) It results from the changes made in the price adjustment either bringing about a reduction in the exchange rate of through the "gold standard" mechanism, i.e., reducing the domestic price level. Import restrictions may be preferred on the ground of terms of trade but certain unused opportunities in the optimum tariff direction will exist and this will be useful from the point of view of economic development. A proper allocation of resources will be needed induce and the adversely affecting terms of trade induce such movements in the production and in the allocation of increasing resources which in the long run reverse the unfavourable change taking place in the terms of trade. "If, for instance, a devaluation restores the payments balance but causes for the present a worsening in the terms of trade, in the longer run factors will respond to the change in the price relations by moving from export to import competing industries. This movement need not disturb the balance but will at least tend to repair the terms of trade".\(^2\)

In this way, the problems of payments which is faced in the short run because of adverse changes in the external demand becomes a terms of trade problem in the medium run and eventually a problem of economic growth in the long run. Changes in external demand have a crucial influence on the direction of growth.

The most fortunate are the countries which enjoy a vigorous demand for those products in which they enjoy comparative advantages and can specialise. They can advantageously employ their increasing stock of productive resources and are able to import a variety of goods needed for their programme of economic development. Similar was the view expressed by the U.N. experts in the Report on Measures for Economic Development of Underdeveloped Countries. For example, "foreign trade policy should be tested not only whether it is more or less autarchic, or creates more or less diversification, but by whether it leads to a situation where all things considered, nothing is produced at home which could in practice be bought abroad for a smaller quantity of resources and vice versa, that nothing is bought abroad which could be produced at home with a smaller quantity of resources." ¹

Thus, the choice in regard to the kind of industrialization goes in favour of the importance of keeping the general level of tariff down and as exports are really the "Joker in the Pack" the underdeveloped countries should concentrate on the development of industries on a long-term competitive basis. But as the trade among the countries of more or less equal per capital income and high consumption pattern is greater than trade among the countries with large differences in income, the successful implementation of this policy requires tariff reforms and abandonment of the Most Favoured Nation Principle in order to eliminate discrimination.

¹ United Nations, op.cit., p. 57.
To deal realistically with these problems, the Prebisch preferential trade proposal as a logical extension of the infant industry argument in 1964 United Nations Conference on Trade and Development is of considerable importance. The developed countries should reduce the tariff on the import of manufactures and semi-manufactures from the low-income countries to a level which would be below the tariff applied on the imports from other advanced countries.¹ The most favoured nation principle should be given up in order to promote the economic development of all underdeveloped countries. Any policy such as this which has the effect of increasing the export from these countries would have an additional effect of inducing a flow of foreign private capital in response to the extra profits and new trade opportunities. It would also enable them to earn more foreign exchange to purchase capital goods for the construction of new productive capacity and absorb the increasing resources. It is a major advantage of export oriented strategy that it is likely to contribute to the capital supply rather than as the import substitution policies to discourage the foreign private capital in the underdeveloped countries.

The picture of world trade with which we conclude is one of change. If trade was an engine of growth during the 19th century the progress of technology in the developed market economies and the consequent reduction in their demand for the primary products

imported from the underdeveloped countries, has reduced the significance of growth through the export of raw materials and goods. More problems are faced due to the increase in the productive factors which cannot advantageously be employed in the primary goods sector, whose external demand is price inelastic and slowly expanding. Thenew trade policy should mean the development and encouragement of manufacturing industries embodying a larger supply of labour. It requires a complementary policy on the part of the advanced countries to accept the cheap manufacturing products, revising their tariff structure, providing an increasing volume of financial assistance and granting certain preferences to the goods imported from the low-income countries. It would enable these countries to earn foreign exchange which would in turn, be spent on the import of essential capital goods required for financing the programme of their economic development. If this were implemented, there would be an enormous flow of private foreign capital in the underdeveloped countries in response to new trade opportunities and the pattern of growth may, in this way, well exceed the international trade of 19th century as an engine of growth.