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Trade Problems of Third World Countries

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INTRODUCTION

Most of the developing countries still export mainly the traditional primary commodities for which the world demand is growing at a slow rate. Thus these countries cannot significantly expand their export earnings by exporting the primary commodities. It is, therefore, vital for the developing countries to expand their exports of industrial goods. In view of the persistent deficits and increasing external debt obligations of these countries, there is a desperate need for the rapid expansion of their export earnings. For this the developing countries will have to industrialize their economies rapidly. Industrialization strategy can be based either on import substitution or export promotion policy.

CONSTRAINTS OF DEVELOPMENT

The developing countries are becoming increasingly conscious of the limitations of industrialization strategy based on import substitution. This is because indiscriminately import substitution policy results in gross misallocation of resources and hence lower the growth rate in the country. The building up of local industries behind the tariff walls makes their exchange rates overvalued. An overvalued exchange rate discourages manufactured exports by at least two ways. Firstly, it reduces the profitability of exporting as an activity with overvalued exchange rate, the domestic currency value of foreign exchange earnings is reduced below the rate that would be set by a more appropriate or equilibrium exchange rate. Secondly, imported inputs or domestically produced imports-competing inputs have to be purchased by the export industries at above world prices and this results in higher prices of export industries.

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Thomas K. Morison (1976), in a cross country analysis of the export performance of 18 to 45 developing countries, found that nominal tariff rates were negatively correlated with export performance of manufacturing industries. The higher are tariffs, the lower the export performance. Openness of an economy measured by share of imports in Gross National Product is positively correlated with manufacturing export performance. The greater the openness of an economy, the better the export performance.

In view of the limitations of industrialization strategy based on import substitution, it will be better for the developing countries to industrialize their economies through export-promotion policy. But the industrialization strategy based on export-promotion policy can be successfully executed only if the advanced countries give greater market access to manufactured goods from the developing countries.

Tariff and Non-tariff Barriers

Though the average tariff in the industrial countries, after the Tokyo round of trade talks, has been reduced, but industrial countries' tariffs are still much higher on imports of industrial products from developing countries in which the latter have a comparative cost advantage. Industrial countries now use such non-tariff barriers as voluntary export restraints (VERS) and volume controls more often than price controls. Non-tariff barriers are used most often to protect agriculture, followed by textiles and iron and steel. These non-tariff barriers cover 21 percent of the industrial exports of developing countries compared with only 14 percent of the industrial countries intra trade of the same products.

Although, under the scheme of General System of Preferential Tariff Rates (GSP), preferential treatments were given to the imports of manufacturing goods from developing countries, but this scheme has given limited benefits to the developing countries because of following reasons:

- Many agricultural, fishery, textile and leather products have been excluded. It is estimated that more than 60 percent of all dutiable manufacturing imports from developing countries were excluded. Thus GSP scheme covered mainly those products in which the developing countries cannot compete.
- Low preference margin was given under the GSP scheme. Only 30 percent reduction of prevailing rates was granted. In view of very

high tariff rates on the imports of industrial goods from developing countries 30 percent reduction in tariff rates did not mean much.

- In order to avoid low imports from low-wage countries, safeguard mechanism was attached to GSP scheme whereby donor countries can withhold partially or fully preferential treatment when imports threaten or cause serious injury to domestic producers. The European Economic Community (EEC) countries and Japan placed ceilings on preferential imports whereby imports in excess of the ceilings are charged full rather than GSP rates. For sensitive products, each beneficiary developing country cannot supply more than 20 to 30 percent of each product's duty free quota.

The escalated tariff structure in developed countries discourages the expansion of processing industries in developing countries. The tariff rates increase as the stage of processing advances. For instance, the developed countries impose no tariff on hides and skins, levy low duty on leather products and levy high duty on furnished leather goods. Because of the escalated tariff structure, the effective rates of tariff protection on finished products substantially exceeds the nominal rate. In EEC countries, for instance, effective rates exceed nominal rates by 30 percent on average. The discriminating effect is more powerful on the imports of labour intensive, low technology products e.g. textiles, sports goods, footwear and processed food-stuffs in which developing countries have comparative advantage.

Falasy of Developed Countries

The developed countries are not making structural adjustment in accordance with changing patterns of comparative advantage. The developed countries have lost the comparative advantage in labour intensive and low technology products and they have gained the comparative advantage in capital and skill intensive, and high technology products. Thus it is in the long term interest of developed countries to bring structural adjustments in their production patterns.

The restrictive quotas, ceilings, voluntary export restraints agreements and high effective protection on labour intensive products are defensive mechanism to avoid social and economic costs of structural adjustment. As long as high effective tariff rates on products of export interest to the developing countries remain in force, quantitative restrictions and voluntary export restraints are not lifted and, developed

countries do not implement effective adjustment programmes, market access for developing countries remains problem.

Secular Deterioration in Terms of Trade

The other trade problem being faced by the developing countries is the secular deterioration in developing countries' terms of trade. Empirical studies show that the terms of trade might have gone against developing countries for short periods, but in the long run such tendency is not found. If fall in export prices reflects productivity gains, then the country may be getting more imports per unit of factor service devoted to export production. In order to obtain higher unit values for primary commodities, there is a need for creating international buffer stocks for the main export commodities of developing countries. The developed countries can contribute funds for financing such schemes. In order to get better terms of trade, the developing countries should start exporting more of manufactured goods for which the world demand is increasing rapidly. The decrease in the import demand for manufacture goods by developing import-competing industries would help in getting lower import unit values for these goods.

Another trade problem being faced by developing countries is the instability in their export earnings. In some developing countries, the bulk of their export earnings come from two or three primary commodities. But the international prices of primary commodities fluctuates widely from time to time. In the years when prices of the primary commodities fall, their export earnings decline and their export earnings rise in those years when prices of primary commodities increase. The instability in the export earnings can have detrimental effects on the country's development because in the absence of developmental imports and revenue, the work on different projects cannot continue smoothly. The instability in export earnings is not only caused by wide fluctuation in prices of primary commodities but also by instability in export volume of primary commodities. To maintain commodity price within a specified range, there is a need for the establishment of series of international buffer stocks for the main export commodities of developing countries. Under the *Integrated Commodity Programme*, the proposal is to set up a series of international buffer stocks for the main export commodities starting with ten core commodities namely coffee, cocoa, sugar, tea, tin, cotton, copper, jute, rubber and sisal. These buffer stock schemes are to

be financed through a common fund. Another element of *Integrated Commodity Programme* is the call for increased processing of raw-materials in developing countries as processing of primary commodities creates value added and contributes to higher employment and export earnings. According to some estimate, the developing countries at present receive only 15 to 20 percent of the final selling price of their produce. In this context it is worth to mention here the Lome Convention of 1975, which was attended by the EEC and 52 developing countries, that incorporates a commodity scheme (STABEX) which seeks to protect ACP (African, Caribbean and Pacific Countries) against fluctuations in export proceeds.

Policy Implication

The domestic and commercial policies followed by the developing countries are also responsible for the trade problems of these countries. Governments directly control all import restrictions in many developing countries. Average custom duties and charges on a large number of goods imported by developing countries are 10 percent, or more than twice imposed by industrial countries. Not only the developing countries rely more heavily on tariff and non-tariff trade barriers but also the measures they impose on imports are applied more erratically than are those used by industrial countries. The reason is that some of these barriers begin with strategic policies to protect selectively a weak domestic sector or industry, but they more often end up being used to achieve other goals, notably to manage balance of payments problem. The net effect is to restrict trade and to reduce domestic competition. Countries that have established industries behind highly restrictive import regimes have never been able to raise these industries to compete in the world economy. Highly restrictive trade regimes have resulted in overvaluation of their currencies and this has adversely affected the exports of those developing countries. Conversely, countries with neutral trade policies are able to promote local industries with the potential to achieve parity with international competitors. South Korea is an obvious example of how a less restrictive trade regime can benefit a developing country. Korea has allowed its exporters access to materials at international prices. That access, in turn, has allowed Korea an expansion of more than 10 percent a year over the past two decades.

Production Rigidity

Apart from highly restrictive trade regimes, these countries have less flexibility in their production pattern. They have concentrated their production efforts in producing traditional primary commodities for which world demand is growing slowly. Less attention has been paid by these countries for predicting and exporting non-traditional primary commodities such as fruits and vegetable, dairy and livestock products for which world demand has been and will continue to grow at fast rate. It therefore, becomes the responsibility of developing countries to change their production pattern of exports in accordance with the change in the world demand of these products.

CONCLUSION

In order to export more of the manufactured goods, they should improve the quality of their products, make timely deliveries and provide after sales services. Besides this, they should remove the overvaluation of their currencies through devaluations and they should pursue expenditure-cutting policies for bringing down their inflation rates in line with world inflation rate. In order to reduce dependence on the industrial countries, it may be desirable for the developing countries to develop intra-trade among themselves. Since the developing countries are at different stages of economic development, a large part of import requirements including capital goods can be met from the export availabilities of these goods from the fellow developing countries.

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