
GLOBALIZATION AND THE DEVELOPING WORLD: AN ESSAY ON THE INTERNATIONAL DIMENSIONS OF DEVELOPMENT IN THE POST-COLD WAR ERA

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Table of Contents

Preface

The first version of this study was prepared for the United Nations Development Programme as a background document for the Human Development Report 1992. It is not surprising therefore that some of the ideas in this study bear more than a passing likeness to parts of this year's Human Development Report. This study, however, covers a number of issues not raised in the UNDP publication and, where there is overlap, the treatment sometimes is different and more extensive.

We are grateful to Mahbub ul Haq for giving us an opportunity to explore some of the international dimensions of human development and later allowing us to publish this essay. We are also grateful to Inge Kaul and her colleagues at UNDP for supplying some of the data used in this study. Our research assistant at the University of California, Riverside was Terry McKinley. His help, too, is much appreciated.

Initial thoughts on globalization were stimulated when Keith Griffin visited the OECD Development Centre in Paris in 1990. Charles Oman, Louis Emmerij (the President of the Development Centre) and other colleagues kindly commented on an essay which attempted to outline the major issues for research for the Centre's proposed project on "globalization and regionalisation". At Üner Kirdar's suggestion, some of these ideas were presented at a UNDP sponsored meeting of the North South Roundtable in Antalya, Turkey. Parts of this study also formed the basis for seminars at the University of Southern California, the North-South Institute in Ottawa, Canada and the University of California, Riverside. We are grateful to the participants at the seminars for their constructive suggestions. James Mittelman kindly commented on the first draft of this study and we are grateful to him for giving us the perspective of a political scientist.

Chapter 1: Introduction

The ultimate purpose of development is to expand the capabilities of people, to increase their ability to lead long and healthy lives, to enable them to cultivate their talents and interests, and to afford them an opportunity to live in dignity and with self-respect. The means by which this is achieved may be diverse--by increasing the stock of physical capital, introducing new technologies, changing institutions, altering incentives. Equally important, and sometimes more important, are investments in human capital--the provision of education and training, the creation of employment and opportunities to acquire skills while on the job, the provision of primary health care and adequate nutrition, expenditure on research and on seeking out new sources of information. Both these ideas--development as capability expansion and as human capital formation--are captured in the phrase human development and throughout this essay we shall take development to mean human development. [1]

It is now widely recognized that at the national level, an increase in output or in gross domestic product (GDP) does not translate automatically into an improvement in people's well being or in human development. National growth is neither necessary nor sufficient, although rising per capita incomes can certainly facilitate an increase in human capabilities and human development. The linkage between economic growth and human development can be weak for a variety of reasons. First, there may be a high concentration in the ownership of productive assets, particularly land, such that a large proportion of the economically active population may be denied access on reasonable terms to the means of production. Second, partly because of this, there may be great inequality in the distribution of income and a pattern of growth that accentuates inequality with the passage of time. Third, there may be unequal access to technology, credit and productive inputs and to opportunities for employment. Fourth, the coverage of the social services, particularly education and primary health care, may be uneven both in terms of geographical availability and quality. Finally, entrenched power structures, lack of democracy and grass roots participation, restraints on civil liberties and the freedom of the press, and repressive political regimes can be used to channel the flow of income arising from growth to particular groups of the population (the political elite, large property owners, upper income groups) to the disadvantage of the poor. These points have been well documented and are no longer the subject of great controversy.

What is true at the national level is even more true at the international level. The spreading mechanisms that in principle can but often do not translate economic growth into an improvement in people's well being at the national level either are absent at the international level or are weak. A major reason for this is the weak and uncoordinated institutions for international economic governance. First, international decision making powers, insofar as they exist, are concentrated in a small number of rich countries, namely, the Group of Seven (G-7) of the United States, Canada, Japan, the United Kingdom, France, Germany and Italy. Thus insofar as the global economy is managed, it is managed for the benefit of the G-7 countries. Second, there is no international mechanism for raising resources analogous to a national progressive income tax. Regular contributions to the United Nations system no longer are progressive; extra-budgetary contributions to the U.N. are irregular, unpredictable and not progressive; contributions to foreign aid programmes are voluntary, unprogressive and a falling proportion of the national income of donor countries. Third, there is no international commitment, and few institutions to implement a commitment, to create a social safety net for the poor and most vulnerable groups among the world's population. The boundaries of the welfare state coincide with national boundaries and there are few mechanisms for translating sentiments of international solidarity into effective action.

Compounding the problem of absent or ineffective international institutions are structural features of the world economy that inhibit "trickle down" processes of human betterment. First, there is the high degree of international inequality in the distribution of income. Second, there are enormous differences in the technology available to rich countries and poor. Third, there is the relative lack of mobility of labour internationally as compared to the much higher degree of mobility nationally. Thus low income labour is unable to migrate readily from poor countries to rich and thereby ensure, on a global level, that the returns to equivalent skills and effort are equalized. Fourth, as we shall see, there is at best only a weak tendency for capital to move from rich countries to poor. Most capital movements are from one rich country to another and thus do nothing to spread the benefits of growth to the lowest income people in the lowest income countries.

The result has been a tendency for inequality in the world distribution of income to increase. This can be seen in Table 1.1 where Gini coefficients are presented for both real gross domestic product per capita (measured in purchasing power parity terms) and gross national product per capita. The Gini coefficient for real GDP per capita rises sharply from 0.44 in 1960 to 0.55 in 1988 while the coefficient for GNP per capita rises from 0.71 in 1970 to 0.85 in 1989. These changes are so large that there can be no doubt that inequality has increased dramatically since the 1960s.

Also included in Table 1.1 are estimates of the range of per capita world incomes. The range is measured as the share of world income received by the richest 20 per cent of the population divided by the share received by the poorest 20 per cent of the population. In the case of real GDP per capita (measured in purchasing power parity terms) the range of incomes increased from 11.1 to 1 in 1960 to 17.1 to 1 in 1988. That is, in 1988 the richest 20 per cent of the world's population enjoyed an income 17.1 times as large, on average, as the poorest 20 per cent.

Table 1.1: The distribution of world income, 1960-1989

	Real GDP (PPP) per capita		**GNP per capita**	
Year	**Gini coefficient**	**Ratio of top 20% to bottom 20%**	**Gini coefficient**	**Ratio of top 20% to bottom 20%**
1960	0.44	11.1	n/a	n/a
1970	0.50	13.9	0.71	31.9
1980	0.53	16.0	0.79	44.7
1988/9	0.55	17.1	0.85	54.5

Note: The distributions in this table, and similar data reported in the text, were calculated by assuming that within each country every person received the per capita income of that country. That is, intra-country inequalities in the distribution of income were ignored. The effect of this assumption is to understate the degree of global inequality.

Source: United Nations Development Programme.

Changes in the world distribution of income over long periods of time reflect differences in trend rates of growth of per capita incomes among groups of countries. During the period 1965-89, GNP per capita in the low income economies increased 2.9 per cent per annum, compared to 2.3 per cent per annum in the middle-income and 2.4 per cent in the high-income economies. (See Table 1.2.) At first glance this suggests a tendency towards greater equality rather than the reverse. The picture changes, however, if one disaggregates the low-income economies into three groups--China, India and other low-income countries. China did indeed grow much faster than the world average, but India and the other low-income economies grew much slower than average. Unfortunately, India and the other low-income economies account for 1.8 billion people or 38 per cent of the population of the countries represented in Table 1.2. This fraction of the world's population, well over a third of the total, has found itself slipping ever further behind the rest of the world. At the international level the benefits of global growth have not trickled down in full measure to many of the poorest people on the globe.

Table 1.2: Population size, per capita income and the growth of GNP per head

	Population 1989 (millions)	**GNP per capita** 1989 (US dollars)	**Growth of GNP per capita** 1965-89 (per cent per annum)
Low Income Economies	2,948.4	330	2.9
China	1,113.9	350	5.7
India	832.5	340	1.8
Other Low Income	1,002.0	330	1.4
Middle Income Economies	1,104.5	2,040	2.3
High Income Economies	830.4	18,330	2.4

Source: World Bank, World Development Report 1991.

Another way of making the same point is to compare changes in the share of global GNP between 1960 and 1989. During that period the share of countries with the richest 20 per cent of the world's population rose from 70.2 per cent to 82 per cent, whereas the share of countries in global GNP with the poorest 20 per cent of the population fell from 2.3 per cent of the total to 1.5 per cent. Per capita GNP grew 2.7 times as fast in the top quintile as in the bottom, namely, 2.53 and 0.91 per cent per annum respectively.

We have noted the very rapid growth of per capita income in China. This highlights the unevenness of economic development among the developing countries. Some regions during the period 1965-89 grew much more rapidly than others. The low- and middle-income countries as a whole grew 2.5 per cent per capita per annum. Four out of the five regional groups, however, grew less rapidly than the average (Sub-Saharan Africa, South Asia, Latin America and the Caribbean, and Europe, the Middle East and North Africa) while only one (East Asia) exceeded the average. At one extreme, Sub-Saharan Africa experienced almost no growth of income per head while at the other extreme, East Asia enjoyed very rapid growth. Indeed East Asia's average income increased 17 times more rapidly than did Sub-Saharan Africa's! (See Table 1.3.) Given the very large population in East Asia, the rapid growth in East Asia is cause for great satisfaction, but the fact remains that if one takes a twenty-five year view, large parts of the developing world have grown less rapidly than the global average.

Table 1.3: Uneven Development: Growth of GNP per capita in five developing regions 1965-89
(per cent per annum)

Sub-Saharan Africa	0.3
South Asia	0.8
Latin America and the Caribbean	1.9
Europe, the Middle East and North Africa*	2.4
East Asia	5.2
Low-and-Middle-Income Countries	2.5

Source: World Bank, World Development Report 1991.

Moreover, growth in the developing regions did not always rise and fall with growth in the world economy as a whole. That is, the unevenness of development is also reflected in a lack of synchronization in the direction of change in growth rates. Some regions experienced an acceleration of growth while others experienced a deceleration of growth and even an absolute decline in average living standards. This can be seen in Table 1.4, where the growth in GDP per head during 1965-80 and 1980-89 is compared.

Table 1.4: Growth of GDP per capita, 1965-80 and 1980-89
per cent per annum and percentage points

	1965-80	1980-89	Change
Sub-Saharan Africa	1.5	-1.1	-2.6
Sub-Saharan Africa	1.5	-1.1	-2.6
South Asia	1.5	2.8	+1.5
Latin America and the Caribbean	3.5	-0.5	-4.0
East Asia	5.0	6.3	+1.3
Low and Middle Income Countries	3.5	1.7	-1.8

Source: World Bank, World Development Report 1991.

The rate of growth of per capita output in the world economy fell by 0.8 percentage points between 1965-80 and 1980-89, or by over a third. In the developing countries as a whole the decline in growth rates was 1.8 percentage points. The deceleration in growth was especially severe in Sub-Saharan Africa (2.6 percentage points), Europe, the Middle East and North Africa (3.2 points) and Latin America and the Caribbean (4.0 points) and in fact in two of these regions (Sub-Saharan Africa and Latin America) growth rates were actually negative. In East and South Asia, in contrast, there was a sharp acceleration of growth by 1.3 and 1.5 percentage points, respectively. That is, Asia as a whole managed to increase its rate of growth during the 1980s despite the general decline in growth rates in the rest of the world. Development was uneven temporally as well as spatially. Once again this shows that at the global level the processes of "trickle down" either are absent or very weak.

This cursory review of the evidence suggests (i) that growth is uneven at the level of the global economy, (ii) that some developing regions can experience absolute economic decline while others are enjoying a rapid rise in income per head, (iii) that some of the poorest regions of the world, notably Sub-Saharan Africa and South Asia, have experienced a relative deterioration in their levels of income, (iv) that therefore the benefits of global growth do not necessarily spread automatically to the poorest countries or to the poorest people and consequently, (v) that expansion of the international economy does not translate automatically into human development for the world's poor.

There is thus a strong case for international policies to be devised and implemented to ensure that opportunities for human development are distributed more evenly and equitably. These international policies cannot substitute for national policies but they can complement them. Indeed international and domestic policy reforms should be seen as closely linked. In the absence of a supportive international environment, national policies may be partially frustrated. But equally, in the absence of appropriate national measures, international reforms may merely increase the resources available to national governments without any guarantee that the benefits will reach the intended beneficiaries.

A note on the measurement of growth rates

It has been argued by some specialists that the conventional method of estimating the growth rate of a group of countries, adopted in the tables of this chapter, is not appropriate. The argument runs as follows. Consider two countries, R (rich) and P (poor), of equal size in terms of population. R's income in the base year is ten times the income of P. Over a given period R's income declines by one per cent while P's income increases by 10 per cent. The conventional measure of the aggregate growth rate is zero, since the absolute fall in total income in R is matched by an equivalent rise in total income in P. Yet the rate of growth of income of an average person was 4.5 per cent. This would be apparent if the aggregate growth rate were measured as the average of the population-weighted growth rates of individual countries. The World Bank has argued that measured in this way the performance of the developing countries, and of the world as a whole, was considerably better in the 1980s than conventional indicators suggest:

While trends in GDP-weighted GDP per capita support the notion that the 1980s was to some extent a "lost decade" for developing countries as a group, population-weighted GDP per capita in developing countries appears to have increased about as fast during the 1980s as during the years leading up to the first oil crisis. If economic performance is to be assessed according to the change in income of the "typical individual", the 1980s would score higher than the 1970s. An assessment of the progress of global development therefore needs to include population-weighted income in its list of performance indicators. **2**

The principle is certainly valid, but it must be applied consistently and in particular the growth rate of an individual country should be calculated as the average of the growth rates of incomes of each individual. Otherwise population-weighted growth rates, if they are interpreted as the change in income of the "typical individual", must rest on the implicit assumption that the distribution of income within each country remains unchanged. This is hardly a correct assumption. Consider the claim that population-weighted growth rates in developing countries were high during the 1980s. This claim largely rests on the extraordinarily high rate of growth in China, the most populous country of the world. During the 1980s, however, the distribution of income in China became substantially more unequal. **3** The average of the rates of growth of individual incomes in China would therefore be lower than the conventionally measured growth rate of per capita income. By the same token the true population-weighted global growth rate would be lower than the population-weighted average of conventionally measured growth rates of per capita incomes of countries. The claim that the "typical individual" in the developing countries experienced a higher rate of growth of income during the 1980s than during the 1970s is something on which judgement must be reserved until proper estimates can be made.

Chapter 2: International Trade Issues

In recent decades the distance between poor and rich countries has decreased in terms of two of the three components of the human development index.4

Longevity and knowledge in the developing countries have increased faster than the world average and only the gap in per capita income between the two groups of countries has widened. If global income inequality continues to increase however this may eventually limit the ability of developing countries to improve their relative performance on the human development index. Relatively slow growth not only will affect directly the income component of the human development index, it probably will also have adverse implications for longevity and knowledge by affecting expenditure on health, nutrition and education.

It is now widely recognized that sustained improvement in human capabilities is not possible without growth in income, although rapid economic growth is not automatically translated into higher levels of human development. If the poorest countries of the world are to improve their levels of human development it is necessary, though not sufficient, to ensure that they have adequate resources to finance the investment necessary for rapid growth and to finance substantial expenditures on human development activities.

International economic circumstances affecting both trade and factor movements have a strong influence on the volume of resources available for growth and human development. Trade flows determine the capacity to import and this, in turn, affects the degree to which developing countries have access to modern productive technologies. Growth in the volume of exports and favourable terms of trade also have positive effects on the rate of investment. International factor movements can help to improve a country's resource endowment by increasing the supply of capital and other scarce factors relative to abundant factors such as labour.

In this chapter we present an analysis of trends in international trade and their effects on the capacity of developing countries to generate resources for development. In the next chapter we deal with the effects of international flows of labour and capital.

The point of departure is the concentration of international commerce among a small group of countries and hence the restricted impact of the benefits of trade on the majority of the world's people. Unfortunately international trade not only is highly concentrated, it is becoming more so as time passes. In 1970, for instance, countries accounting for the richest 20 per cent of the world's population accounted for 80.8 per cent of global trade. By 1989, the share of these countries had risen to 84.4 per cent. In contrast, countries accounting for the poorest 20 per cent of the world's population in 1970 accounted for 1.3 per cent of global trade. By 1989, the share of the poor had risen marginally to 1.5 per cent, presumably at the expense of the middle 60 per cent of the world's population.

The capacity to import

As indicated in Chapter 1, during the decade and a half preceding 1980 the developing countries as a whole experienced a higher rate of growth in per capita income than the developed countries. During the 1980s, however, this pattern was reversed. Associated with the decline in relative growth rates was a sharp fall in the capacity to import of the developing countries. During the 1980s the capacity to import of the developing countries as a group declined both in relation to their own past performance and in comparison to the import capacity of developed countries. As can be seen in Table 2.1, imports in almost all developing regions declined absolutely during the 1980s, notable exceptions being China and India and the middle income countries of East and South-East Asia. This is in sharp contrast with the previous decade when all developing country groups experienced rapid increases in the dollar value of imports. Admittedly the figures are in current dollar values and it is well known that prices of internationally traded goods increased much more slowly during the 1980s than during the 1970s, but the conclusion would be unaffected even if imports were converted to real values, i.e., even if imports were measured in volume terms.5

Table 2.1: Annual Growth Rates in the dollar values of Merchandise Trade

	1970 to 1980		1980-1989	
	Exports	**Imports**	**Exports**	**Imports**
Sub-Saharan Africa	20.8	20.2	-6.0	-3.2
South Asia	14.2	18.5	6.8	4.6
East & South-East Asia & the Pacific	27.0	23.8	9.4	8.7
Latin America & the Caribbean	20.1	20.9	0.5	-2.8
Middle East & North Africa	27.1	25.5	-3.5	-0.7
Developing Countries	21.6	20.9	2.8	2.1
Low Income Countries	21.9	21.0	2.0	4.4
Low Income Africa	21.0	20.2	-9.1	-4.4
China & India	20.0	22.5	6.0	11.0
Other Low Income	25.9	20.5	0.3	2.3
Middle Income Countries	21.5	20.82	-3.1	1.5
High Income OECD	18.88	19.7	-6.0	5.2

Note: Regional groups include only developing countries. Source: The World Bank, World Tables, 1991.The volume of exports and the terms of trade

The decline in the growth of the capacity to import of the developing countries as a whole and the absolute decline in the capacity to import for major groups of developing countries were not due to a decline in the volume of their exports. For the developing countries as a whole and for all major regional groups of developing countries except Sub-Saharan Africa, the rates of growth of the volume of exports were as high as or higher than the corresponding rates of growth during the preceding decade and a half (Table 2.2). The decline in import capacity was due to (i) a decline in the terms of trade (Tables 2.2 and 2.3) and (ii) a reduction in the net inflow of foreign capital (discussed in the next chapter).

Table 2.2: Growth of Export Volume and Changes in the terms of Trade
(Average Annual Percentage Change)

	1965-1973		1973-1980		1980-1989	
	Exports	TOT	Exports	TOT	Exports	TOT
Developing Countries	5.1	0.1	3.5	2.1	5.2	-3.0
Middle Income	3.9	1.0	3.5	1.9	5.3	-3.2
Low Income	10.4	...	3.5	...	4.9	...
Sub-Saharan Africa	14.2	-6.7	-0.2	-5.7	-1.0	-4.9
East & Southeast Asia	10.6	3.3	9.4	0.3	9.4	-1.4
South Asia	-0.2	3.3	4.5	-3.1	6.1	1.0
Middle East & North Africa	...	...	-0.6	5.7	5.2	-5.1
Latin America & Caribbean	-0.4	3.1	2.2	1.2	4.0	-2.1
OECD	9.5	-1.1	5.4	-3.3	3.8	1.1

Note: Regional Groups include only developing countries. ... means not available.

Source: World Bank, World Development Report 1991, Table A.10.

Table 2.3: Terms of Trade Indices: 1980 = 100

	1965	1970	1975	1985	1989
Developing Countries	40	38	73	96	74
Petroleum Exporters	19	18	59	101	55
Other Developing Countries	99	106	115	91	88
Developed Countries	120	122	109	101	112

Source: UNCTAD, Handbook, 1989.

For the decade and a half prior to the first oil shock in 1973, the developing countries as a whole experienced no trend decline in their terms of trade. Indeed in most cases the terms of trade improved. Sub-Saharan Africa was the only exception to this pattern. After the first oil shock South Asia also suffered a decline in the terms of trade. But the developing countries as a whole experienced an accelerated improvement in their terms of trade during 1973-80 because of the sharp improvement in the terms of trade of oil exporting developing countries. The developed OECD countries experienced a decline in their terms of trade during 1965-73 and a further worsening in 1973-80.

During the 1980s these trends were reversed. The developing countries as a whole, as well as most of the major groups of developing countries, including the oil exporters, experienced a rapid deterioration in their terms of trade while the terms of trade of the developed OECD countries improved. South Asia was the only developing region which managed to avoid a decline in the terms of trade in the 1980s and in fact South Asia recorded a modest improvement.

Policies of the developed countries

During the 1980s the developing countries not only experienced a decline in their share of total world trade, the share of the developed countries in the exports and imports of the developing countries also declined (Table 2.4). That is, world trade increasingly came to consist of trade among already developed countries. Thus exports from developed countries to other developed countries rose from 71.2 per cent of their total trade in 1980 to 76.6 per cent in 1989. Trade among the developing countries as a proportion of the total trade of developing countries increased substantially, namely, from 26.2 per cent of their total trade in 1980 to 32.1 per cent in 1989. Thus the decline in the terms of trade of the developing countries can be seen as a consequence of a failure of demand in the advanced OECD countries to expand. That is, the demand for exports on the part of the developed countries failed to grow as rapidly as the supply of exportables in the developing countries.

Table 2.4: Direction of Trade: Exports 1980-89
Percentage

Origin	Destination	Developed Market Economies	Developing Countries
Developed Market Economies	1980	71.2	24.4
	1985	74.0	22.2
	1989	76.6	19.6
Developing Countries	1980	69.3	26.2
	1985	61.6	31.8
	1989	62.5	32.1

Source:UNCTAD Secretariat quoted in United Nations, World Economic Survey, 1991, p. 219.

Two major factors account for the sluggish demand in the OECD countries for the exports of the developing countries: (i) the decline in the rate of growth of the OECD economies and (ii) the weakening of the forces of trade liberalisation and the erection of barriers to trade in the OECD countries. Although the rate of growth of per capita income in the OECD countries exceeded that of the developing countries as a whole, there was an appreciable decline in growth rates in the OECD after the mid-1970s. As a result there was a slower growth in demand for the exports of the developing countries. A recent World Bank study estimates that a one percentage point decline in OECD growth rates causes a 0.7 percentage point decline in the rate of growth of the developing countries, in part as a result of a reduction in the volume of exports and partly as a result of a decline in the terms of trade of developing countries. 6

The effect of slow growth in the developed countries has been exacerbated by the rise since the mid-1970s of new non-tariff barriers to trade in the OECD countries. The same World Bank report referred to earlier makes the following observation (p. 9):

By 1986, almost 16 per cent of OECD imports were covered by non-tariff barriers. Voluntary export restraints and quotas consistently slipped through the proscriptions of various GATT articles, antidumping actions became highly arbitrary, and rules relating to origin and local content proliferated... Twenty of the twenty-four OECD economies are, on balance, more protectionist now than they were ten years ago.... Because non-tariff barriers are most often imposed in sectors in which developing countries are internationally competitive - leather products, textiles, clothing, footwear, travel goods, and beverages... - they affect developing countries more than they do industrial countries....

Increased protectionism in the OECD countries and the consequent decline in the share of exports of the developing countries absorbed by the OECD countries have been associated with an increased importance of regional trading blocs involving OECD countries. Already trade among the members of the European Community accounts for 56 per cent of their total trade. Trade among the North American countries accounts for 42 per cent of the total international trade of those countries. 7 Forthcoming developments in the European Community and in North America are likely to create conditions for a further increase in the share of intra-regional trade among the advanced countries. Regional trading blocs among the developing countries, in contrast, have not resulted in a comparable concentration of intra-regional trade among themselves.

Policies of the developing countries

None the less, protectionism continues to be widespread in the developing countries and it is easy to envisage reforms in the trade regime that would encourage the growth of commerce among developing countries. The available evidence suggest, however, that some developing countries have already introduced policies to improve their trade regime. Table 2.5 includes data on the real effective exchange rate in 16 developing countries. In 13 of these 16 countries the real exchange rate declined, often very sharply, during the 1980s. 8 In addition, fewer developing countries now rely on direct controls on imports to manage their trade. The rising share of intra-developing country trade was undoubtedly stimulated by these changes. The reduction in the degree of overvaluation of the exchange rate has reduced discrimination against exporting in the developing countries and, in contrast to the developed countries, there has been a move toward a more open trading system. Clearly the developing countries can do much more to reform their foreign trade policies, but the significant point is that during the 1980s their policies began to move in the right direction, rather than the wrong one.

Table 2.5: Real Effective Exchange Rates In Selected Developing Countries
(1980-82 = 100)

	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	
Argentina	107.5	77.0	71.6	80.2	71.0	61.1	53.7	59.9	51.7	60.3	
Brazil	103.2	113.0	86.0	85.7	85.2	74.9	74.3	81.4	99.2	118.7	
Chile	108.1	97.3	89.3	90.1	79.6	68.8	65.7	61.5	60.8	55.4	>
Columbia	100.4	105.9	104.9	99.6	86.1	68.1	63.7	61.5	60.8	55.4	
Israel	99.2	108.7	120.8	119.5	106.6	101.0	97.6	107.1	109.4	105.8	
Mexico	114.1	82.7	79.0	91.9	87.4	62.8	64.6	107.1	109.4	105.8	
Peru	103.2	105.1	98.5	105.8	96.8	97.0	108.8	130.0	139.9	183.6	
Venezuela	99.2	110.2	117.3	85.9	93.0	90.7	65.3	72.0	63.2	>	52.5
Hong Kong	99.4	101.4	94.9	99.5	103.6	94.07	90.0	90.7	98.8	99.1	
Indonesia	99.7	111.7	96.2<	96.0	94.7	53.6	56.1	54.1	55.7	57.5	
Malaysia	99.3	105.6	113.9	119.6	116.3	95.5	89.51	80.4	80.0	75.7	
Philippines	101.2	106.7	96.19	107.9	114.7	91.0	87.7	89.5	95.70	88.4	
Republic of Korea	101.2	101.9	97.6	97.6	89.4	76.4	75.7	882.4	92.3	85.3	
Singapore	101.9	100.8	101.8	102.5	95.7	80.9	74.6	73.2	78.2	81.1	
Taiwan Province of China	102.6	96.6	94.6	97.1	94.2	86.4	91.7	95.2	100.9	94.0	
Turkey	104.4	96.1	94.2	89.6	89.82	71.9	63.8	65.1	73.7	76.8	

Source: Morgan Guaranty Trust Company, World Financial Markets, various issues, quoted in United Nations, World Economic Survey, 1990.

The retardation of diversification

It once was argued that there was a secular tendency for the terms of trade of developing countries to decline. The explanation for this was the concentration of exports of developing countries on primary products with low income and price elasticities of demand. Given the substantial diversification of exports of developing countries in favour of manufactured goods in recent years, how does one explain the decline in the terms of trade during the 1980s? One factor has already been mentioned, namely, the bias of incremental OECD non-tariff protection against the products in which developing countries have a comparative advantage. Table 2.6 contains evidence on some additional factors. First, diversification of exports from developing countries proceeded at a rapid rate during the 1960s and 1970s. Between 1967 and 1981 the share of non-fuel primary products in total exports declined by nearly two-thirds. During the 1980s this tendency was reversed and the share of non-fuel primary products in total exports actually increased between 1981 and 1988. Second, the table also indicates that between 1975-77 and 1985-87 there was only a small decline in the number of developing countries in which more than half their export earnings were generated by three or fewer commodities. That is, many countries continued to be highly dependent on a few commodities for most of their foreign exchange earnings.

Table 2.6:
A. Exports of Primary Goods as a Percentage of Total Exports of Developing Countries (Excluding Fuels)

1967	52.9
1973	38.3
1981	18.2
1987	21.0
1988	21.7

B. Number of Countries in Which Three Commodities Account for More Than 50 Percent of Exports

	1975-1977	1985-1987
Latin American & Caribbean	32	30
Africa	44	43
Asia & Pacific	31	23

Source: UNCTAD, Commodity Yearbook, 1990.

The failure of developing countries to continue to diversity their exports during the 1980s combined with the continued dependence of a very large number of developing countries on a few export commodities contributed to a sharp decline in the terms of trade as well as to a great deal of uncertainty about export earnings and the capacity to import. Instability of commodity prices though varying greatly from one commodity to another, has on average been high. Moreover, instability in commodity prices appears to have increased over time (Table 2.7). 9

Table 2.7: Variability of World Prices of Selected Agricultural Commodities

Commodity	1950-59	1960-69	1970-79	1980-89
Bananas	2.2	3.0	3.3	3.4
Cocoa	8.7	7.5	9.7	7.2
Coconut Oil	5.2	3.8	13.3	15.9
Coffee	6.3	3.0	11.7	7.4
Copra	6.4	4.0	14.4	14.3
Cotton	4.0	1.5	6.7	5.9
Groundnut Oil	3.9	3.1	7.8	10.3
Maize	2.0	3.3	7.5	7.1
Palm Oil	4.3	4.6	8.4	10.5
Rice	11.4	3.4	14.9	7.2
Rubber	9.1	4.3	6.3	4.3

Sugar	7.8	21.7	25.4	20.4
Tea	6.2	2.2	6.9	10.7
Wheat	1.7	1.6	12.0	4.4

Source: World Bank, Global Economic Prospects and the Developing Countries, 1991, p. 23. Figures refer to the mean of the squared percentage deviation of observed prices from trend forecast prices.

The reversal of the trend towards greater diversification of exports of developing countries during the 1980s was associated with and may have been caused by deceleration in the rates of investment and growth that many of these countries experienced. Gross domestic investment as a percentage of gross domestic product declined between 1980 and 1989 for the developing countries as a whole and for most regional groups, namely, Sub-Saharan Africa, Latin America and the Caribbean, South Asia, and North Africa and the Middle East. The only group of developing countries for which the investment ratio increased is the middle income countries of East and South-East Asia.

Prices of manufactured exports of developing countries performed much better than prices of primary commodity exports. But even the prices of manufactured exports often were disappointing. During 1980-86 the prices of manufactured goods exported by developing countries actually declined by an average annual rate of 2 per cent. Thereafter they rose sharply but even so, for the period 1980-89 the average annual rate of increase was barely 0.6 per cent. In contrast, the prices of manufactured goods exported by the OECD countries increased at an average annual rate of 2.6 per cent during 1980-89. 10

Conclusions and suggestions for policy

The combination of slow growth in the OECD countries and increased non-tariff protection in those same countries, often directed against products in which the developing countries have a comparative advantage, led to a decline in the terms of trade and a reduced capacity to import in the developing world in the 1980s. This happened in spite of a significant increase in trade among developing countries and positive policy changes which moved them towards a more open economy. The effects of the negative external environment outweighed the benefits of internal policy reforms and as a result the developing countries found it increasingly difficult to continue to diversify their economies, to invest for growth and to finance urgent human development programmes. The retardation of diversification of their exports exacerbated these problems.

In discussing the policy reforms needed to redress the unfavourable external circumstances we shall assume that both developed and developing countries are willing to change and wish to ensure an adequate flow of resources to the developing countries. In Chapter 4 we discuss the "domestic" policies that developing countries should adopt to achieve their human development goals if unfavourable international circumstances persist and international reforms prove to be impossible. We concentrate here on international policies and actions concerned with trade flows, leaving to the next chapter a discussion of policies concerned with flows of capital and labour.

Let us begin with the trade policies of developed countries.

International efforts to secure changes in the trade policies of the developed OECD countries should be directed to three main objectives: (i) to stimulate growth; (ii) to reduce protection, especially non-tariff measures directed against exports from developing countries; and (iii) to ensure that regional trading blocs adhere strictly to the spirit of the GATT rules and avoid measures that divert trade from the developing countries.

The first of these objectives, the stimulation of growth in the OECD countries, might appear to be paradoxical given another objective of reducing the distance in human development between the developed and the developing countries. Yet faster growth in the OECD is necessary in order to stimulate the demand for exports of the developing countries. If the estimates of the World Bank are correct, each percentage increase in the rate of growth in the OECD should translate directly into a 0.7 percentage point increase in the rate of growth of the developing countries.

Must the growth of the developing countries then lag behind the growth of the developed countries? The answer is no and here the second policy objective is relevant. The elasticity of growth of the developing world with respect to OECD growth could be increased by reducing non-tariff protection against developing country exports. That is, purposefully directed trade liberalization could increase the responsiveness of incomes in developing countries to higher aggregate demand in the developed countries. This is one reason why it should be an objective of international policy to abolish completely non-tariff barriers to trade from developing countries within the present decade.

The third policy objective is intended to avoid the emerging danger of fragmenting the global economic system into a number of trading blocs each dominated by developed countries or consisting exclusively of such countries. Unless adequate safeguards are introduced, the forthcoming changes in the European and North American trading blocs could have strong adverse effects on the trade of some developing countries.

There is an asymmetry between the advanced and the developing countries when it comes to forming trading blocs. The success of trading blocs depends critically on the exploitation of economies of scale arising from the increased size of the market. But the size of the market depends on the volume of expenditure, not on the number of persons living inside the bloc. A bloc consisting of several medium sized rich countries is large enough to cross the threshold size for most industries, and therefore trading arrangements among industrialized countries, while unnecessary, are likely to be successful. A grouping of several large but poor countries, however, would not contain enough purchasing power to sustain a wide range of industries of minimum efficient scale. Regional economic blocs of developing countries often are inadequate substitutes for free access to the markets of rich countries. This, rather than an inability to resolve regional disputes and to forge friendships with neighbouring countries, is one important reason for the limited success of trading blocs among developing countries. Only in East Asia and Latin America, with their large number of upper middle-income countries, do the conditions for successful economic integration exist. Even in these regions, trading blocs are likely to be built around a dominant regional economic power, namely Japan and the

United States, respectively. The poorest regions of the developing world --Sub-Saharan Africa and South Asia--are unlikely to be able to construct effective trading blocs that can challenge regional trading groups led by the developed OECD nations.

Hence it is in the interests of most poor countries to require blocs to observe the rules of free trade. Where this is not possible, the trade bloc of developed countries should be asked to grant preferences, in the form of exemptions from common external tariffs, to exports from poor countries. For example, an international agreement could be reached under the auspices of the United Nations to permit free entry into all OECD markets of those products in which the poor, labour abundant economies have a comparative advantage.

Turning now to the trade policies of developing countries, these should focus on (i) continued reform of their foreign trade policies; (ii) reduced discrimination against other developing countries and where possible increased cooperation to promote trade among themselves; and (iii) greater diversification of exports. These objectives are closely related to one another.

Much can be learned from the development experience of the last four decades about the way developing countries should organize their foreign trade policies. For many years the most common policies for industrialisation in developing countries centred on heavy protection of import substituting enterprises producing for the domestic market. The foreign trade regime associated with this strategy included an overvalued rate of exchange buttressed by physical import controls and high tariffs, often accompanied by direct controls on foreign exchange and capital movements. Among the consequences of this set of policies were the following: (i) inefficient industrialisation fostered by an absence of international competition and a failure to exploit economies of scale because of the limited size of the domestic market; (ii) an inefficient allocation of resources resulting from arbitrary and uneven rates of effective protection, themselves an inevitable consequence of relying on physical controls on trade; (iii) discrimination against exporting; and (iv) greater inequality in the distribution of income.

While these disadvantages have been widely discussed, one ill effect has received less attention than it deserves. When most or all developing countries have overvalued rates of exchange, this harms intra-developing country trade. The effect of widespread overvaluation makes importing a good from a developing country artificially more expensive than importing the same good from an advanced country. The reason for this is that payments for traded goods are made in convertible currencies, i.e., the currencies of the developed countries, and it is these very currencies against which the currencies of the developing countries are overvalued. This phenomenon could well have been an important explanation for the slow growth of trade among developing countries during the 1960s and 1970s.

We have seen, however, that in recent years many developing countries have introduced more realistic exchange rates and eliminated many arbitrary physical controls on trade. These reforms still have a long way to go but progress has been made. The developing countries should persist with these reforms and institutionalise a foreign trade regime in which exchange rates are realistic; uneven and arbitrary protection is replaced by the sensible promotion of activities in which the country has a comparative advantage; and specialisation is based on exploiting the potential of both domestic and international markets and thereby taking advantage of the benefits of economies of scale.

This is not the same as *laissez faire* or unbridled free trade. The countries which have successfully implemented this recommended strategy--notably East Asian countries such as the Republic of Korea--have clearly shown that much more than *laissez faire* free trade is involved. The state in these countries has played a leading role in providing infrastructure, promoting specific industrial activities and creating a set of incentives which encourages the economy to move in the desired direction. There was plenty of protection, but the protected industries were not allowed to become perpetual infants, nor were incentives biased against sales in foreign markets. Instead infant export industries often were protected and promoted so that they could compete globally and challenge established producers in international markets.

A reformed trade regime should also create a firm basis for cooperation among developing countries by ending discrimination against imports from other developing countries. In addition, whenever possible developing countries should take advantage of opportunities to undertake joint ventures and generally coordinate international specialisation among themselves. While the developing countries have nothing to gain from an international system fragmented into antagonistic trading blocs, they should take advantage of any opportunities that arise for beneficial regional cooperation.

Finally, the developing countries should do what they can to encourage greater diversity of their output and exports. One precondition for successful, efficient diversification is the restoration of rapid growth in those countries which experienced stagnation or decline in the 1980s. Faster growth will of course require a higher level of investment. Both accelerated growth and higher investment, in turn, depend on changes in economic policies in both the developed and developing countries.

Footnotes:

1: For a full discussion of human development see Amartya Sen, "Development: Which Way Now?", Economic Journal, December 1983; Keith Griffin and John Knight, eds., Human Development and the International Development Strategy for the 1990s, London: Macmillan, 1990; UNDP, Human Development Report 1990 New York: Oxford University Press, 1990.

2: World Bank, Global Economic Prospects and the Developing Countries, Washington, D.C., May 1991, p. 68.

3: A. R. Khan, Keith Griffin, Carl Riskin and Zhao Renwei, Household Income and Its Distribution in China (draft), University of California, Riverside, 1991. **4**: The three components of the index are longevity (measured by life expectancy), knowledge (measured by adult literacy and average years of schooling) and standard of living (measured by a function of per capita income). See technical note 2 of the Human Development Report 1991 for details.

5: For all developing countries import prices increased at an annual rate of 6 per cent during 1965-73, 12.3 per cent during 1973-80 and 0.1 per cent during 1980-89, according to data in the World Development Report, 1991 (derived from information in Table A.10, p. 189). While precise estimates cannot be made, it is clear that the volume of imports increased far more rapidly during the 1970s than during the 1980s.

6: See World Bank, Global Economic Prospects and the Developing Countries, Washington, D.C., May 1991, p. 50.

7: Ibid, p. 9.

8: This would appear to have been the case also in India and China, the two largest developing countries not included in the Table.

9: World Bank, op. Cit., indicates that the trend of instability, estimated by regression analysis of ten-year moving averages of coefficients of variation over the last four decades, has been positive for all 14 crops considered except cotton and rubber.

10: These estimates are derived from World Bank, World Development Report 1991, Table A.10, p. 189.