

Terms of Trade

Concept: Terms of Trade

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Description During the era of formal political decolonization and its aftermath, Third World countries undertook collective actions to better their economic standing in the international economy relative to the rich countries. This territorially-based community — a "trade union" of poor nations — made especially strong efforts to change the world trading system (Haq 1976). It attempted to secure new rules to stabilize and raise the prices of principal sources of export earnings: primary products. A view shared by many coalition members was that international exchanges of raw materials for finished goods were unequal and impoverishing in the long run. This understanding was referred to as the Third World's "terms of trade" argument. It was deployed as part of the broader attempt to overcome the legacies of colonialism and achieve a more autonomous future.

Previously, developed countries had made individual efforts to better their terms of trade (a concept that can be defined mathematically as the ratio of average export prices to import prices in a given country or group of countries). Since the Industrial Revolution, states such as Germany and the United States had pursued more favourable terms of trade through imposing tariffs on selected imports. This policy option induced the world price of the targeted products to decline relative to the prices the country applying the tariff received for its exports. However, the limitations of this approach were revealed in the 1930s when such moves escalated and a generalized retreat into protectionism ensued.

Nearly twenty years later, Hans Singer (1950) and Raul Prebisch (1950) penned papers that many now consider to have stimulated the collective activism of Third World states. Working independently within the UN system, first Singer, and then Prebisch, concluded that there was a "secular" or long-term downward trend in the terms of trade between primary products and manufactured goods. They noted that technological progress and economic growth in the rich countries increased the demand for manufactures there relative to the demand for agricultural produce, as consumers with higher incomes could only spend a limited amount of their increased purchasing power on more food. Consequently, they argued that demand for the Third World's exports was limited, or as economists term it, "inelastic." Prebisch and Singer also showed that productivity was increasing more rapidly in the South than in the North, thereby reducing the prices Third World countries fetched for their exports relative to the costs of their imports. The overall message was that reliance upon agricultural and other primary commodity exports — often a direct result of colonialism — led to a transfer of incomes from the South to the North over time. The

essence of their position was that the same amount of coffee exports, for example, year after year would enable the purchase of fewer and fewer technological goods imports. As such, Singer concluded that primary product exporters were unintentionally subsidizing the North's rising living standards. Prebisch echoed this position, and argued that measures to improve terms of trade, in general, might lead to welfare gains in the Third World and increase the resources available for development.

The Prebisch-Singer thesis was controversial at the time of its articulation, and remains so in the discipline of economics to this day. One reason for debate early on was that their work inverted the standard position of nineteenth century political economists on declining terms of trade (Toye and Toye 2003). The old thinking had been that the prices of manufactured goods would decline relative to agricultural products as populations expanded. Now the contest is largely about the explanatory power or validity of their thesis as regards the record of the twentieth century, though the issue of what exactly their data sets showed is still debated (Hadass and Williamson 2001).

Empirically speaking, several recent studies indicate that terms of trade declines have been especially harmful for the group of vulnerable states designated by the United Nations as the Least Developed Countries (LDCs), and especially Sub-Saharan African countries that do not export oil. At least forty-three countries continue to rely upon exports of three or fewer non-oil primary commodities for 20 to 90 percent of their export earnings (Watkins and Fowler 2002; FAO 2004; UNCTAD 2004). These heavily-indebted countries have remained marginal players as world trade volumes have expanded, and they have generally not been able to diversify their economies out of export-oriented agriculture and raw materials production. In 2000, prices of their eighteen major export commodities were 25 percent lower in real terms than they were in 1980 (Watkins and Fowler 2002). Regarding agriculture specifically, over a forty-year period ending in 2001, real prices for LDC exports declined relative to the prices of their manufactured goods imports by almost 70 percent (FAO 2004). According to the FAO study this trend was more severe in recent times. Between 1986 and 2001 the LDCs saw their agricultural terms of trade cut in half. Including all sectors, since the early 1960s, LDC terms of trade have also declined by half. Due to this trend, one study estimates that the non-oil exporting nations of Sub-Saharan Africa have lost fifty cents on every dollar sent to the region in aid since the early 1970s (Watkins and Fowler 2002). Overall, factors such as the development of synthetic products, productivity increases elsewhere, and protectionism in the developed countries have exacerbated low earnings.

As regards the BRICSAM countries — Brazil, Russia, India, China, South Africa, Association of Southeast Asia Nations (ASEAN) members and Mexico — and other major emerging markets and developing world oil exporters, the terms of trade argument seems to hold less well in the recent period. Many of these states have been able to achieve economies

of scale in the production of certain primary products, such as cotton or corn, and have diversified their economies away from exclusive reliance upon raw material exports. The predictions of Prebisch and Singer also do not seem to fit too neatly the situation of countries that rely upon extractive industries for foreign exchange earnings. However, the national accounts of a number of these states benefit from a collective pricing arrangement (Organization of the Petroleum Exporting Countries) that was clearly inspired by the terms of trade argument.

In the present era of globalization, negative terms of trade continue to undermine the livelihoods of a significant number of people in the poorest countries. Resurgent Third World solidarity at the level of states, evident at the 2003 WTO Ministerial Meeting in Cancun, has focused the attention of the international community on the pricing problems associated with the commodities. Yet it remains far from a sure bet that the Doha Round will achieve outcomes for the poorest countries which will redress their long-standing grievances. Even so, a growing transworld movement might be altering the negative results historically associated with poor terms of trade at the level of individuals and local collectivities in ways that interstate activism has thus far been unable to achieve. The anti-poverty campaigns of awareness-raising NGOs such as Oxfam have helped millions of relatively well off people to find out what they can personally do to better the lives of direct producers. The rise of a market for ethical products and the growth of fair trade certification systems also indicate that there are nascent supraterritorial solutions on offer to a condition historically associated with the international economy. As a consequence, the terms of trade argument has globalized. The discourse of fairness has shifted from one of interstate relations to one of transnational relations, and developments are ongoing.

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