Book Review

International Trade & Economic Development

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Reviewer
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Although the connection between international trade and economic development dates back to Adam Smith and David Ricardo, the subject matter has undergone very rapid change in the last two decades. Not only new theories as well as theoretical methodologies have been developed, but alongside econometric techniques to validate theoretical conjectures have also undergone significant improvements. The present book fulfils a void in this field since no textbook which specifically deals with interrelations between trade and development is available to teachers and scholars, although some recent international trade texts have covered certain areas analysed in the present book.

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The book starts with an overview of the evolution of trade theories culminating into the present global trade scenario, including recent crisis in Greece. It touches, inter alia, the issue of international trade and pollution and its implication for sustainable development. Chapter 2 and 3 elaborate on the earlier trade and development debates centered around secular deterioration of Terms of Trade (TOT) as espoused by Raul Prebisch and Hans Singer. Chapter 2 has explained the basis of Prebisch-Singer hypothesis along with a critique in terms of various definitions of TOT prevalent in the literature. The chapter has also neatly presented the unequal exchange model stylised by Edmar Bacha. Chapter 3 has taken up the much celebrated immiserizing growth hypothesis along with the problems posed by two-gap analysis. Then an excellent exposition is given for North-South type growth models, originally proposed by Arthur Lewis and Ragnar Nurkse. The particular model highlighted is that written by Ronald Findlay explaining various factors determining the short and long-run TOT.

Foreign Direct Investment (FDI) is still now a subject which has evoked a good deal of interest in the developing countries. A number of analyses in the past have taken up issues about welfare implications of such FDI in the presence or absence of profit repatriation by the parent firms along with the important question whether foreign and domestic capital are complementary or substitute. The topic of transfer pricing by the Multi-National Enterprises (MNEs) was also hotly debated. Chapter 4 of the present book is a refreshing reading since the authors have moved beyond the old debates to such new dispositions as implications of FDI in specific sectors including retail along with the role of FDI in promoting skill formation in developing world. The good thing is that claims are supported by easy to understand models couched in the standard general equilibrium structure popularised by Ronald Jones. The conclusions about impact of agricultural trade liberalisation not affecting wage inequality, while currency devaluation could lower wage inequality, although under restrictive assumptions, are quite thought provoking.

The two chapters on labour migration look at this longstanding issue from a different perspective. The old literature discussed issues like brain drain, migration of skilled versus unskilled labour etc in details. The new theories about labour migration viewed as a substitute of international trade in goods and services, trace out different zones of migration based on the degree of trade liberalisation. In the same vein, the informational asymmetry about migrants plays an important role about wages paid to immigrants compared to natives, leading to serious implications about movement of wage inequality for different skill levels between these two categories of workers.
The chapter on foreign aid again raises certain issues in a different angle. The role of foreign aid is mainly viewed in terms of its impact on savings, investment and growth of an economy. In this context, the role of foreign aid on welfare is discussed based on whether this aid is conditional or not. The impact on global welfare is also analysed in terms of an elegant model. Further, the issue of governance and foreign aid are brought to the limelight in terms of contemporary examples from couple of African countries as well as Bangladesh.

Chapter 8 deals with the connection between trade and poverty. This is also subject to many debates. The authors have highlighted the role of informal sector in the developing economies and its position in international trade. Several models have been discussed dealing with issues like linkage of informal sector with trade related policies like tariff cut. The role of Trade Adjustment Assistance (TAA) to import competing sector workers is analysed rigorously and the impact of wage subsidy on employment is shown to depend on price and income elasticity of imports. The main message is that the impact of wage subsidy can only be understood if skill heterogeneity and nature of protection to displaced labour is formally modelled in a general equilibrium framework.

Regional Trading Arrangements (RTAs) have come to the limelight since 1950s mainly with the advent of EEC in 1957. The standard arguments of Jacob Viner in terms of trade creation and trade diversion are analysed in chapter 9 in terms of large country tariff elimination. A nice presentation is given regarding the debate between Jagdish Bhagwati and Richard Lipsey. The chapter also discusses the simple model of John Spraos regarding the conditions of trade diversion when two inefficient producer countries form a customs union. The authors have brought in new dimensions to the discussion of welfare gains due to the formation of RTAs by bringing in dynamic gains in terms of effect of product innovation by a multinational firm in the presence of intra-country taste diversity. Under the WTO regime, tariffs have been lowered in almost all the trading countries. On the contrary, different kinds of standards have made their strong presence felt, especially for developing country exports to developed markets. Chapter 10 has several interesting models on parallel imports and welfare, TRIPS and innovation, environmental standards leading to unfair trade and ecological dumping as well as labour standards leading to trade sanctions on products having child labour content. It is refreshing to have all such models on standards and trade in one place which has lucidly explained issues using elegant theoretical models. The next chapter has dwelt upon different aspects of outsourcing as well as the economics of export processing zones as a welfare enhancing strategy of development. The concluding chapter discusses the basic
analytics of contagion and global economic crisis, although the authors have avoided rigorous theoretical models this context.

The book has covered a wide ground taking into account some of the old theories as well as modelling a number of recently emerging issues. From a critique’s perspective, the most important aspect which comes to mind is the paucity of dynamic models which really captures the development issues. The thrust of the analysis is the use of static general equilibrium modelling which captures alternative scenarios through comparative static. However, the growth and development are predominantly processes which require dynamic analysis over time. One may take up the chapter of foreign aid which may be sector specific but has varying implications for savings, capital formation, growth and terms of trade movements. Similarly growth and poverty could be explained better through the use of certain types of endogenous growth models. This appears important since there are some models in the book which take care of dynamic movements over time, like Findlay’s model of North-South trade or Helpman’s model of intellectual property rights regimes and innovations in the economy. One hopes the dynamic modelling will have larger applications in future editions of the book.

The other point worthy of noting is the fact that services have not only emerged as the most important sector in the GDP for the majority of the developing countries but also has grown faster than goods trade. Many of these services are complementary to manufacturing trade and have grown alongside merchandise trade. The whole process of outsourcing is contingent upon faster growth of trade in services. Further this might have implications for understanding the impact of trade on skilled wages since such skilled labour are also absorbed in large numbers in services sector which require very little capital and/ or no foreign capital. The present volume does not deal with trade in services which have some interesting recent theoretical developments.

Certain chapters have taken up recent controversies but have not developed the arguments through general equilibrium models. One such example is FDI in retail sector which is almost entirely based on consumer welfare ignoring the impact of such FDI on producers’ surplus as well as on factor markets and on government revenues. Similarly, the chapter on contagion and its transmission has not been presented in terms of rigorous theoretical macro modelling, leaving the readers guessing on the relationship between the real and monetary sectors in such contagion.
The book has a number of typographical and careless errors. For example, on page 44, the notations for marginal propensity to produce and consume in India should be for bicycles but is written as that for carpets. Similarly, on page 61, in the first paragraph, the sentence –“Hence, given (3.24), the long-run equilibrium value of the TOT......”- the equation number should be (3.44). On page 74, “......augmenting effects of foreign capital inflow on (K_1 + K_2)l while......” –the term (K_1 + K_2)l has a typo ‘1’. These are just some examples. On page 114, the statement “substituting Z in (5.7) determines S........” makes no sense since Z nowhere appears in equation (5.7).

Some of the explanations need better intuitions. For example, in proposition 4.1, it is not clear why return to skill does not change. Intuitive explanation for proposition 4.4 is difficult to fathom. In page 74, the implication of the statement that BOP condition is not required in the structure is not clear. Similarly, in Findlay’s model, equation (A 3.20) really shows a modified Marshall-Lerner condition- the modification needs to be explained. Similarly in the section 6.3 of chapter 6, the attitude towards risk has some relation to the labour market condition- whether it is tight or slack. This angle is not explored.

Overall, as mentioned in the beginning, the book is a welcome addition to the literature on international trade and development. The focus of the book is entirely on theoretical understandings of old and emerging issues of interconnections between international trade and economic development. It will certainly be very handy for graduate students, researchers and teachers alike.