EC3355 International Trade
Problem Set 8: Developing countries

1. One relatively common feature in developing countries is high corruption levels. How do corruption levels affect trade?

   Answer: The potential positive effect of corruption on trade is that bribing officials will allow firms to bypass some of the extensive bureacracy often present in corrupt countries. The main negative effect however is that bribing acts as an additional cost similar to for instance transportation costs. Additionally, due to corruption there might be a lot of missing trade in the trade data as not everything will be declared by the officials.

2. Why do African consumers spend a disproportionally large amount of their disposable income on food in comparison with other countries?

   Answer: The have a lower income to start with which means that they will spend more of their disposable income on food and most African countries are net-importers of food which increases prices.

3. In most developing countries the economy depends on the export of a few primary products. How does this affects economic development?

   Answer: The Prebisch-Singer hypothesis is a real worry for these countries. They are also very vulnerable to demand and supply cycles.

4. Both Nigeria and Norway are oil-rich countries but GDP per capita in Norway is 100,818.50 U.S.$ (2013) and in Nigeria it is 3,005.51 U.S. $ (2013). Explain if this supports the resource curse hypothesis.

   Answer: Hard to tell really as these are two very different countries meaning that there are other factors influencing development.

5. In the 1950-1960s import-substituting industrialisation (ISI) was a rather popular policy in many developing countries. Explain why this particular policy was so popular.

Answer: As stated before the Prebisch-Singer hypothesis served as a justification but there were other more important reasons for its popularity such as the infant industry argument and the fact that a lot of countries just became independent and did not really trust the former colonial powers.

6. What are the advantages and disadvantages of ISI? Do you think that ISI can be used to kick-start economic development? Explain why or why not.

   Answer: Some of the advantages of ISI are that for developing countries it is easier to set their own trade policies of course in contrast with trying to influence the trade policy of larger economies. Additionally, protectionism might entice foreign firms to open factories in developing countries in order to get market access (i.e. increase horizontal FDI).

   Disadvantages of ISI are that the protected industries might become less competitive as they don't face competition from more productive foreign competition. Additionally, ISI means that resources such as capital and labour are diverted from potentially very productive sectors that maybe have a larger exporting potential. Finally, since developing countries have small economic sizes this means that it is hard to get economies of scale due to low domestic demand.

   In the current world economy ISI is unlikely to boost economic growth due to some of the disadvantages of the policies given above.

7. Various South-East Asian countries experienced a period of fast economic growth during the 1980-1990s. One thing they had in common was that they implemented export-oriented growth policies. What are the advantages and disadvantages of this type of policy?

   Answer: One of the main advantages is that it is easier to create economies of scaled due to the potentially large size of the export market. This in contrast with the small domestic market under ISI. It also encourages competitiveness in domestic industries with a comparative advantage, in the case of developing countries these are often labour-intensive industries.

   The main drawback of this policy is that the success largely depends on other countries' trade policy, i.e. whether they allow the goods on their market. And as such countries with export-oriented growth policies are sensitive to economic cycles and protective measures.

8. Based on the empirical evidence do you think that export-oriented

growth policies could help countries develop economically?

Answer: It seems like a sensible policy and various Asian countries have used it to their advantage. However, the success of these types of policies in for instance Latin-American countries has been very mixed. In the case of the Asian countries it is also hard to tell whether it was this particular policy that contributed to their growth or whether it was correlated with other important factors such as education for instance and institutions.

9. Over the past decade developing countries have seen large increases in exports. What are the consequences of this for long term prospects of economic development?

   Answer: This increase in exports is mainly driven by India and China whose growing economies have a large demand for raw materials which they import from other developing countries. In the short term this is good news for developing countries as long as the demand remains stable or increases. The question is what will happen in the long term. It still seems that these countries need to diversify their economies for long-term stable economic growth which is a big challenge.

10. The last bullet point on the last lecture slide states that the changing pattern in international trade has interesting consequences for our theoretical models. What does this mean?

    Answer: As the Leontief paradox already showed, the workhorse trade model (HO-model) has relatively little to say on trade flows between countries with similar factor endowments (abundance of land and labour in this case).