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THE FOREIGN-EXCHANGE GAP OF THE DEVELOPING COUNTRIES

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I. *The Setting*

History, which is a continuous process, impresses itself on human minds by discrete events. Wars, technical breakthroughs, disasters, births, and deaths are signposts of history. The United Nations Conference on Trade and Development (UNCTAD), held in Geneva from March 23 to June 16, 1964, was such a signpost.[1]

Before UNCTAD began, Raúl Prebisch, its Secretary-General, stated that the purpose of the Conference was to figure out how to fill the inevitable and growing gap in the balances of payments of developing countries if they are to achieve even the modest annual income growth of 5 percent posited by the UN Development Decade. He thus hinged development to the acquisition of increased foreign-exchange resources by the developing countries. Since the Conference, not only has Dr. Prebisch continued to stress the gap theme, but he has been joined in this by spokesmen from almost every developing country in the world.

What UNCTAD did was bring to an organizational culmination the pent-up frustrations over their state of underdevelopment and their slow progress in escaping from this state of more than two-thirds of the world's nations and population. Like other discrete historical events, UNCTAD did not just come upon the world; it was built up to, and it took place when the buildup was adequate. UNCTAD did not tackle new issues; the Contracting Parties to the General Agreement on Tariffs and Trade (GATT), the International Bank for Reconstruction and Development (IBRD), the International Monetary Fund (IMF), the Food and Agriculture Organization (FAO), other UN specialized agencies, other bodies within the UN itself such as commodity groups, the Economic and Social Council (ECOSOC), and the regional economic commissions, all had been and are dealing on a systematic basis with the issues of underdevelopment. UNCTAD

[1] *The Final Act of UNCTAD* is United Nations document E/CONF.46/L.28 of 16 June 1964. Pages 2-5 of annex B contain the joint declaration of the 77 developing countries made at the conclusion of the Conference; this declaration has become a sort of rallying document for the developing countries ever since.

was an effort to bring these other efforts into a coherent whole, to talk in one place about those famous twins, trade and aid, and to see how they and other elements could help contribute to economic growth.

UNCTAD never could have occurred if these other bodies had not done their evolutionary work since World War II. The continuing machinery that grew out of UNCTAD will not be meaningful unless these other bodies continue to make progress in their specialized fields.

UNCTAD would not have occurred in the absence of substantial previous progress in political independence and economic development. The leading countries in what is called variously the less-developed, the developing, the underdeveloped, the third, the peripheral world, are those which have reached a degree of political and economic maturity and are cognizant of the road ahead. As noted, the goal of the UN Development Decade is an annual income growth in developing countries of 5 percent. The growth rate achieved in the 1950's was 4.4 percent (in the developed countries the rate was only 4.0 percent a year),[2] and there is no evidence that this rate has slackened. UNCTAD, thus, did not take place in an atmosphere of stagnation in the less-developed countries.

The developed countries agreed to participate in UNCTAD and to listen to demands put almost exclusively on them. This, too, is a sign of evolution. There was no need on their part to come and listen to demands; indeed, in previous times, no one would ever have dreamed of suggesting that the developed countries should, so to speak, permit themselves to be put in the dock.

This paper will not discuss UNCTAD, or its continuing organizational machinery, but rather some of the issues which have come to a head at the present time in the thinking of less-developed countries about why their foreign-exchange earnings are impeded seriously by their trading relations with developed countries.

Some definitions may be helpful at this point. There is no accepted classification of countries as developed or less-developed, and the gray area is substantial. The GATT, in its breakdown of industrial and nonindustrial for analytical purposes, includes in the latter all of Latin America, all of Asia except Japan, and all of Africa and the Middle East. Nonindustrial thus includes Australia, New Zealand, and South Africa, and industrial includes Greece, Turkey, Yugoslavia and other European countries. GATT lists the Eastern trading area separately.

[2] All the statistics, unless otherwise specified, in this essay have been taken from either *World Economic Survey*, 1963, Part I (UN Document E/3908, ST/ECA/84, 1964) or *International Trade 1963* (GATT/1964-2), or both.

The UN similarly has three groups for analytical purposes: developed-market economies—North America, Western Europe, Australia, Japan, New Zealand and South Africa; the centrally-planned economies; and the developing-market economies, which make up the rest of the world.

For policy purposes—for instance, whether a country is eligible for exemption from the U.S. interest-equalization tax—it may be significant whether a country is considered developed or less-developed. For statistical purposes, the differences among the various breakdowns are not decisive, but should be kept in mind when analyzing figures.

In my own terminology, I shall use less-developed, underdeveloped, poor, and developing synonymously. I shall use nonindustrial only as GATT uses it, that is, to exclude Australia, New Zealand, and South Africa from the industrial countries.

UNCTAD was a setting, and it will be referred to as such. There are vital development issues other than increasing foreign-exchange earnings, and there are techniques other than trade for obtaining foreign exchange, but these other factors will not be dealt with except as they relate to trade as a foreign-exchange earner.

The organization of this paper will be: first, to discuss in some depth trade and related foreign-exchange issues as the less-developed countries see them; and, second, in the light of these issues, to set forth briefly the "solutions" to these problems which the less-developed countries are suggesting.

II. *Criticisms by the Less-Developed Countries*

The following are some of the elements of their trade and foreign-exchange story as spokesmen from the less-developed countries see them.

A. *Their Diminishing Share of Total World Trade*

The share of the less-developed countries in total world trade has shown a persistent decline over the past decade. Using GATT statistics, the share of the nonindustrial countries was 31.3 percent in 1953, and then almost without exception was lower each succeeding year than the year before. In 1963, the share of the nonindustrial countries was 24.0 percent. The UN statistics show the same phenomenon. The share of the developing countries in world trade declined from 32 percent in 1950 to 21 percent in 1962.

This decline has been an important reason for the general malaise of the less-developed countries over the structure and flow of world trade since World War II. The international institutions established in the aftermath of the war to help in the smooth functioning of world trade and payments have tended to work well, but for the most part the less-developed countries consider themselves only minor beneficiaries. Between 1950 and 1962, the value of exports from the developed-market economies rose by 150 percent; from what the UN calls the centrally-planned economies, that is, the communist countries, the increase was 250 percent; from the developing countries, the increase over this time span was only 50 percent.

The countries that most needed an increase in trade enjoyed the smallest rate of increase—roughly 5 percent annually over the period 1950-1962, as compared with about 9.7 for the communist countries and 7.6 percent for the developed countries. Since the base from which the developing countries started was considerably lower than that of the developed countries, their lower rate of growth was compounded in the absolute figures for growth.

This failure of the less-developed countries to participate fully in the growth of world trade in recent years has been a major disappointment to them. It has come at a time when their emphasis on more accelerated economic growth has been greater than at any previous time in their histories. Economic growth for capital-hungry, and frequently food-deficient, countries normally requires an expansion of imports; this, in turn, requires an increase in foreign-exchange availabilities. It is this conjuncture of events—relatively poor export performance at a time when good performance was demanded—that has left the developing countries uneasy about their role in total world trade.

There are many causes for the relatively poorer performance of the less-developed countries in world trade than the performances of the communist and industrialized countries. These include: actions of the less-developed countries themselves, such as inexplicable red tape in their foreign-trade sector and overvalued exchange rates; the structure of their economies and the items they have to export, points which will be discussed in this paper; the increased production of competing commodities in developed countries; import restrictions in the world's richest countries against many of the products of the world's poorest countries. Whatever the causes, and they are many and complex, this phenomenon of a declining share has led the less-developed countries to seek changes in the structure of world trade, and in the organizations in which present world-trade policy is discussed.

This, of course, is part of the backdrop to UNCTAD, and is the stuff of which future discussions will be made in international-trade forums.

B. *Tribulations of Traders of Primary Commodities*

It may again be useful to cite some figures in order to understand the nature of the trade problem of the world's poorer countries. In 1962, the nonindustrial countries exported $33.3 billion of goods to the world, of which $28 billion, or about 84 percent, were primary products. (The UN figures show developing countries relying on primary products for 90 percent of their exports in 1961, and 85 percent if base metals are not counted as primary products. By primary products is meant foods, agricultural raw materials, metalliferous ores, and fuels.)

The significance of the foregoing figures is that the less-developed countries will have to rely on primary-commodity exports for the bulk of their foreign-exchange earnings for some time to come. The question of export diversification of the less-developed countries into processed and manufactured goods will be discussed subsequently; but it is worth keeping in mind that for most developing countries this diversification, no matter how successful, will not quickly replace their reliance on primary commodities. Any analysis of the trade problems of the less-developed countries must start with an analysis of primary-commodity trade.

1. *Low elasticities of demand*

Figures on elasticities of demand, both relative to the price of the product and to the income of the consumer, while not precise, are clearly indicative of some general conclusions. The major conclusion is that, for many of the key primary products exported by the less-developed countries, both price and income elasticities are low. Within a relevant price range (even though it is difficult to determine precisely what this range is), coffee consumption does not seem to be affected by price changes. Similarly, for wealthy countries like the United States and Canada and those of western Europe, further increases in incomes do not lead to any significant increase in coffee consumption.

These inelasticities do not necessarily prevail for all primary products. For example, meat and feed-grain consumption tend to rise as incomes rise. The same has been true in recent years for soybeans. Some developing countries sell these products, but these seemingly more elastic primary products are exported more by developed than by less-developed countries. Only 19 percent of the meat imported by industrial countries in 1962 came from developing countries; the same 19 percent figure applied to cereals. On the other hand, 99 percent of the coffee, 94 percent of the tea, 85 percent of the cocoa imported in 1962 by industrial countries came from developing countries, and much or all of the remainder probably was transshipped.

The point being made should not be carried too far—since less-developed countries do export such products as petroleum, iron ore, bauxite, oilseeds, etc., which are more elastic both with respect to price and income—but it tends, in general, to be true that many major primary commodities exported by less-developed countries are both price and income-inelastic. Increase in the consumption of these commodities, therefore, tends to be tied primarily to population growth. Viewed from the standpoint of the need for export earnings by the underdeveloped countries, this is a slow process.

2. *Price instability*

Superimposed on this phenomenon of relatively slow long-term growth of demand for their products is the well-known problem of price instability for primary products. It is difficult to state which is the more difficult problem, the secular problem of slow growth of demand or the short-term problem of price instability; but the combination has been a formidable one in the eyes of the less-developed countries in terms of the adverse effect on their export earnings. Viewed from the standpoint of economic development, the secular problem of slow growth in demand is probably more serious, if only because it is, in theory, administratively possible to prevent excessive short-term price fluctuations.

This is a major grievance of the less-developed countries—that price fluctuations have not been reduced sufficiently in recent years. The UN has attempted to make generalized measurements of price instability. One of their conclusions is that many of the commodities supplied solely or chiefly by the developing countries—including natural rubber, most of the fibers (particularly the nonapparel fibers), the palm products (particularly copra), and cocoa and coffee—have had the least stable price movements.

Coffee prices, for example, have fluctuated violently. Using New York market prices for Brazilian Santos 4, prices in the early 1950's moved upwards to 80-90 cents a pound (at which point coffee did prove to be price-elastic). More recently, prices were 33.18 cents in October 1962, 32.73 cents in August 1963, as high as 49.85 cents in March 1964, and at present they are in the low to mid-40's.[3] Cocoa prices have shown comparable fluctuations.

[3] *Coffee and the U.S. Consumer,* a pamphlet issued on April 1 by the Pan-American Coffee Bureau. Present (June) figures are from the press.

For a country projecting a development program, and counting on a particular level of foreign-exchange income from its primary-product exports, downward movements in price can be catastrophic. The problem tends to be compounded in that at the very moment a less-developed country loses income because of price declines, its external credit position also suffers and foreign loans are hard to obtain. When prices increase (as they did by an average of 5 percent in 1964 over 1963), the increased income tends to encourage overproduction.

It may be useful to cite a single figure to illustrate the importance of even small price fluctuations for a product as important as coffee. The trade has estimated that world coffee imports were about 6.4 billion pounds in 1964. A one-cent-a-pound price decline, therefore, if maintained throughout the year, would involve an income decline for all exporters taken together of about $64 million. A 17-cent-a-pound price increase, such as occurred in the period between August 1963 and March 1964, projected over a full year, would involve extra foreign-exchange income of more than $1 billion.

3. *Deteriorating terms of trade*

The theme heard most frequently from spokesmen for less-developed countries in recent years is that the terms of trade (the ratio of export to import prices) of the less-developed countries has shown a steady secular deterioration, and a marked deterioration in recent years.[4] This theme of deteriorating terms of trade lends itself to exploitation. Based on a year when commodity prices were extremely high, say, during and immediately after the Korean War, the index in later years shows an exaggerated deterioration. Some spokesmen of less-developed countries have picked precisely this base and then argued that income losses due to deterioration in the terms of trade have been about equal to the foreign aid given by the richer to the poorer countries; and that foreign aid, therefore, did no more than give back to the underdeveloped countries what was taken away from them through price movements. Such aid, they argue, is therefore no more than their due.

The UN itself has abetted this type of contention by attempting to measure the effect of changes in the terms of trade on what it calls "notional export proceeds", that is, what the export proceeds in some later year would have been if an earlier year's terms of trade had remained unchanged. Argentina's average notional loss, for example,

[4] This theme was first popularized in the 1950's. Hans Singer's article on "Distribution of Gains between Investing and Borrowing Countries, *American Economic Review* (May 1950) and Raúl Prebisch's article on "Commercial Policy in the Underdeveloped Countries," *American Economic Review* (May 1959) are key expositions of this point of view.

was estimated by the UN at $162 million from 1954 to 1960 (1953 = 100); Australia's at $643 million; India's gain at $73 million; the U.S. gain at $383 million.

The concept "terms of trade" is an intellectually satisfying, albeit statistically imprecise, one. The general anticipation, because of the elasticities cited earlier, is that prices of primary products will tend to fall over time. Similarly, the general anticipation is that prices of manufactured goods will not fall over time. In the case of agriculture, the expectation is that increases in productivity will be reflected in lower prices; in industry, the expectation is that productivity increases will be reflected in higher wages—due to labor-union pressure—and stable, if not increasing, prices. Domestically, within the United States, the parity concept for agricultural price supports is a terms-of-trade idea. Spokesmen for less-developed countries often argue that what is good within a country—to support the income of producers of primary products—should also be considered good within the world community. (Some U.S. cynics counter that it makes little sense to enlarge the chaotic U.S. agricultural program to a world scale.)

Propagandists can rig the terms-of-trade figures by base-year selection. For example, Argentina's terms of trade were 106 in 1961 with a 1958 base, but only 77 with a 1951 base; Brazil's were 76 with a 1951 base and 91 with a 1958 base; Venezuela's were 102 with a 1951 base and only 86 with a 1958 base. But, at the same time, it is also true that many key commodities, such as coffee, did show steady price declines during the 1950's, and the selection of any year during that decade as a base would show deteriorated terms of trade for a country like Brazil in 1961. There is undoubtedly some justice to the plaint of less-developed countries about deteriorating terms of trade.

Even apart from the base-year selection, the measurement has its shortcomings. The same manufactured good is not necessarily the same product a decade apart; a 1951 refrigerator, for example, is not the same as a 1961 refrigerator, and these quality changes are omitted in the terms-of-trade calculation. Lower prices do not necessarily mean poor export performance; the terms-of-trade calculation omits quantity. The aluminum industry, whose terms of trade have deteriorated sharply in recent decades, is certainly not worse off today than it was earlier when its terms of trade were higher. Using a 1950 base, India's terms of trade were 103 in 1961 and Venezuela's were 90; yet no one would argue that India's foreign-trade position was better in 1961 than Venezuela's.

The terms-of-trade issue has been discussed at some length because it tends to be repeated parrot-like by practically all spokesmen of less-developed countries. For example, one of the findings in the Final Act of UNCTAD reads as follows: "The difficulties of developing countries were aggravated by deterioration in their terms of trade during the period 1950-62" (page 8). The years chosen were at the onset of the Korean War, when prices were at their highest, and just before prices started moving upward again for many key commodities in 1963 and 1964. "Deteriorating terms of trade" has become a key rallying cry of less-developed countries.

4. *Use of synthetics and substitutes*

It would be incomplete to analyze the difficulties of primary-commodity exporters without discussing the progress of technology. To quote from an UNCTAD document: "One of the main threats to the exchange earnings of developing countries in recent years has come from the competition of synthetics with agricultural raw materials, principally cotton, wool, jute and allied fibers, hard fibers (mainly abaca) and rubber."[5]

There is an incentive, particularly in times of shortage and high prices for natural commodities, to invest time and money in research for synthetics. On the other hand, there is little incentive on the part of the rich countries to invest money in research for alternative uses of primary products produced only in the underdeveloped countries. With the principal exception of petroleum, technology, therefore, has tended to work mainly in one direction—to reduce the scope of markets for those primary products produced in the less-developed countries. (It has not necessarily reduced the uses for primary products produced primarily in the richer countries—for instance, various uses have been found for corn.)

The FAO has noted that, using 1952 as 100, raw-cotton production in 1962 was 125; wool production was 127; production of man-made fibers was 228 and, of the last, production of noncellulosics was 835. (The noncellulosics are the polyamides such as nylon, the polyesters such as dacron, the acrylics such as orlon, and polyvinyl fibers.) The production index in 1962 was 118 for natural rubber compared with 255 for synthetic (with 1952 again as 100).

The foregoing are by no means all the synthetics which compete with natural products. Synthetic detergents can be made from a petroleum base instead of with vegetable or animal fats and oils. Plastics

[5] "Synthetics and Their Effects on Agricultural Trade," prepared by the Food and Agriculture Organization for UNCTAD (E/CONF.46/59 of 6 March 1964), p. 1.

replace metals. Synthetics have taken a large part of the market from hides and skins in the manufacture of footwear.

In addition to synthetics, substitutes are often found for natural products produced in large part by less-developed countries. Paper napkins have taken over much of the market from cotton napkins. Paper is also used extensively instead of cotton for handkerchiefs. Paper has replaced jute in packaging.

Over and above the development of synthetics and substitutes, technology has improved to the extent that manufacturers can economize on the use of raw materials. It takes less tin to make a tin can.

A full statistical and economic analysis has not been attempted of the impact of synthetics, substitutes, and improved production techniques on the sales of basic commodities on which less-developed countries depend. All that has been attempted is to make the point that this impact has been profound. Further, this impact is irreversible, and, indeed, can be expected to proceed apace.

This impact is a major concern of the less-developed countries. Their spokesmen do not really want to stop the world, but they do talk of possible mixing regulations in developed countries to prescribe a certain minimum-percentage use of natural products. They also talk, more constructively, about research in alternative uses for some of the basic products they produce—for example, an attempt to do for coffee what has been done for petroleum in the petrochemical industry.

Too high prices for natural materials will encourage the use of substitute or synthetic materials. Too high prices for natural rubber could wipe out sales of natural rubber. Too high prices for cocoa could reduce its consumption drastically. Coffee is not infinitely price-inelastic. Less-developed countries would like higher prices for their export products, but they do recognize that there may be a limit to how high.

5. *Other impediments to exports of primary commodities*

The foregoing is by no means a complete list of factors seen by the less-developed countries as limiting their foreign-exchange earnings from exports of primary commodities.

Possibly the single factor most galling to them is the tariff and non-tariff barriers imposed against their primary products by developed countries. These barriers take various forms.

For products which may be competitive with identical or analogous production in developed countries, there are tariffs and quota restrictions. In the United States, for example, restrictions apply to such products as oils and oilseeds, sugar, lead, zinc, and petroleum. (In